OVERSIGHT HEARING ON THE GRACE REPORT; OPERATION OF VA HOME LOAN GUARANTY PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND MEMORIAL AFFAIRS

OF THE

COMMITTEE ON VETERANS' AFFAIRS
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

SECOND SESSION

MARCH 15, 1984

Printed for the use of the Committee on Veterans' Affairs

Serial No. 98-42

U.S. GOVERNMENT PRINTING OFFICE
33-959 O WASHINGTON : 1984

H761-16

COMMITTEE ON VETERANS' AFFAIRS

G. V. (SONNY) MONTGOMERY, Mississippi, *Chairman*

DON EDWARDS, California
BOB EDGAR, Pennsylvania
SAM B. HALL, Jr., Texas
DOUGLAS APPLEGATE, Ohio
MARVIN LEATH, Texas
RICHARD C. SHELBY, Alabama
DAN MICA, Florida
THOMAS A. DASCHLE, South Dakota
WAYNE DOWDY, Mississippi
MATTHEW G. MARTINEZ, California
LANE EVANS, Illinois
MARCY KAPTUR, Ohio
FRANK HARRISON, Pennsylvania
ALAN B. MOLLOHAN, West Virginia
TIMOTHY J. PENNY, Minnesota
HARLEY O. STAGGERS, Jr., West Virginia
J. ROY ROWLAND, Georgia
JIM SLATTERY, Kansas
JOHN BRYANT, Texas
JAMES J. FLORIO, New Jersey

JOHN PAUL HAMMERSCHMIDT, Arkansas
CHALMERS P. WYLIE, Ohio
ELWOOD HILLIS, Indiana
GERALD B. H. SOLOMON, New York
BOB McEWEN, Ohio
CHRISTOPHER H. SMITH, New Jersey
DENNY SMITH, Oregon
PHIL GRAMM, Texas
DAN BURTON, Indiana
DON SUNDQUIST, Tennessee
MICHAEL BILIRAKIS, Florida
NANCY LEE JOHNSON, Connecticut

MACK G. FLEMING, *Chief Counsel and Staff Director*

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS

RICHARD C. SHELBY, Alabama, *Chairman*

DOUGLAS APPLEGATE, Ohio
ALAN B. MOLLOHAN, West Virginia
DAN MICA, Florida
JOHN BRYANT, Texas
JAMES J. FLORIO, New Jersey

CHRISTOPHER H. SMITH, New Jersey
DON SUNDQUIST, Tennessee
MICHAEL BILIRAKIS, Florida

CONTENTS

MARCH 15, 1984

Page

Oversight Hearing on the Grace Report; Operation of VA Home Loan Guaranty Program 1

OPENING STATEMENTS

Chairman Richard Shelby 1
Hon. Christopher H. Smith 4
Hon. Michael Bilirakis 10

WITNESSES

Heilman, John F., national legislative director, Disabled American Veterans 28
Prepared statement of Mr. Heilman 115
Johnson, Richard W., Jr., director of legislative affairs, The Non Commissioned Officers Association of the United States of America 32
Prepared statement of Mr. Johnson 169
Magill, James N., special assistant, National Legislative Service, Veterans of Foreign Wars of the United States 30
Prepared statement of Mr. Magill 146
Mahn, Robert J., senior vice president, mortgage operations, Federal National Mortgage Company 20
Prepared statement of Mr. Mahn 60
Miller, Joseph E., assistant director, National Legislative Commission; and Paul S. Egan, deputy director, National Legislative Commission, the American Legion 29
Prepared statement of Mr. Miller and Mr. Egan 122
Moran, Robert, associate legislative director, Paralyzed Veterans of America 31
Prepared statement of Mr. Moran 153
Passamaneck, Lt. Col. David J., national legislative director, AMVETS 33
Prepared statement of Col. Passamaneck 178
Rhoades, Dennis, executive director, Vietnam Veterans of America 31
Prepared statement of Mr. Rhoades 160
Starbuck, Dorothy L., Chief Benefits Director, Veterans' Administration; accompanied by John P. Murphy, General Counsel, and Robert M. O'Toole, Director, Loan Guaranty Service 5
Prepared statement of Miss Starbuck 39
Shepherd, Kathleen W., principal analyst, Congressional Budget Office 17
Prepared statement of Ms. Shepherd 47
Wynn, Ronnie J., president, Colonial Mortgage Co., Montgomery, Ala., appearing on behalf of the Mortgage Bankers Association of America; accompanied by Burton G. Wood, MBA's legislative counsel, and William E. Cumberland, MBA's general counsel 22
Prepared statement of Mr. Wynn 74

MATERIAL SUBMITTED FOR THE RECORD

Statements: Blinded Veterans of America 181
Written committee questions and their response: Hon. Christopher H. Smith to Veterans' Administration 45

OVERSIGHT HEARING ON THE GRACE REPORT; OPERATION OF VA HOME LOAN GUARANTY PROGRAM

THURSDAY MARCH 15, 1984

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS,
COMMITTEE ON VETERANS' AFFAIRS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9 a.m., in room 334, Cannon House Office Building, Hon. Richard C. Shelby (chairman of the subcommittee) presiding.

Present: Representatives Shelby, Applegate, Mica, Smith of New Jersey, Sundquist, and Bilirakis.

OPENING STATEMENT OF CHAIRMAN SHELBY

Mr. SHELBY. The subcommittee will come to order.

This morning we are meeting to conduct an oversight hearing on the VA home loan guaranty program. In particular, the committee will be focusing on a proposal contained in the fiscal year 1985 budget that the Veterans' Administration no longer respond to defaults on VA guaranteed loans by acquiring foreclosed properties. Rather, the Veterans' Administration would be required to pay all lending institutions the guaranteed portion of the loan—thereby leaving the loanholder to dispose of the property. This is a major departure from the way it works today.

Fortunately, this proposal, which would have become effective March 1, 1984, has been put on hold temporarily. As we know, however, when you put things on hold temporarily, they come back to visit you.

I am concerned about this proposal. It would be harmful to our veterans, especially potential first-time homebuyers, as the lending community has indicated that tighter underwriting policies would have to be implemented. It could also result in larger indebtedness for veterans whose loans are foreclosed.

It has also been suggested that veterans might have to start making downpayments and that the payment of higher points might be in order, thus negating all of the beneficial aspects of the existing and widely used VA program.

According to a CBO draft report on the impact of this proposal, any savings would be short-lived and would ultimately create larger Federal deficits in future years than if they continued with the existing policy.

In my opinion, this OMB proposal is a perfect example of budget manipulation and a quick fix: Make it look good now and worry about the future later. Certainly a solution to the current problems with the revolving fund must be found. However, the elimination of property acquisition is a very short-sighted solution and could lead to the ultimate termination of this program. In my opinion, we cannot allow this to happen.

I would like the record to show that the subcommittee invited the Office of Management and Budget to appear today to explain and defend the implementation of the Grace Commission's recommendations. As chairman of the subcommittee, I felt that OMB would want to appear to explain the impact of their proposal on the VA guaranty loan program. OMB elected not to appear. Instead, the VA witnesses will speak for the administration.

At this point in the record I would like to include the letter of invitation that I sent to Mr. Stockman. Without objection, it will be included.

February 27, 1984

Mr. David A. Stockman
Director
Office of Management and Budget
Washington, DC 20503

Dear Mr. Stockman:

On Thursday, March 15 at 9:00 a.m. in Room 334 of the Cannon House Office Building, the Subcommittee on Housing and Memorial Affairs will conduct an oversight hearing on the VA home loan guaranty program.

The hearing will also focus on the potential impact of a proposal containted in the FY '85 budget that the Veterans Administration no longer respond to defaults on VA guaranteed loans by acquiring foreclosed properties but rather pay all lending institutions the guaranteed portion of the loan and leave the loan holder to dispose of the property.

We will also hear from the Veterans Administration on their efforts to establish a government wide policy on acquiring foreclosed property.

As you are aware, members of your staff and members of the Committee staff have met in regard to this policy change. Should you wish to appear and present a statement, please contact Mrs. Gloria Royce of my Subcommittee staff at 225-9164.

It is requested that oral presentations be limited to 5 minutes. Please be assured, however, that your complete written statement will be made a part of the hearing record. It is further requested that 75 copies of your statement be delivered to Ms. Arlene Burnett of the Committee staff at least 48 hours prior to the hearing.

Sincerely,

RICHARD SHELBY
Chairman
Subcommittee on Housing
and Memorial Affairs

Mr. SHELBY. Today we have 11 witnesses with us. Some organizations have submitted statements, or plan to shortly. Without objection, the hearing record will remain open for 5 days so that their statements may be included in the hearing record.

I would also like to ask each of our witnesses this morning to follow the longstanding policy of the committee of limiting your oral remarks to 5 minutes so that the subcommittee members will have an opportunity to ask questions if they so desire. We will, of course, as always, include your entire written statement in the record.

At this time I want to recognize the ranking minority member, Congressman Smith of New Jersey.

OPENING STATEMENT OF HON. CHRISTOPHER H. SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. CHRISTOPHER SMITH. Thank you, Mr. Chairman.

The hearing this morning results, Mr. Chairman, from widespread concern over a proposal of the Grace Commission. That Commission has concerned itself with possible savings of Federal dollars and we certainly can applaud its objectives. But, Mr. Chairman, this proposal has extreme opposition in the mortgage and veterans community. I think it deserves our intense scrutiny and I congratulate you for scheduling this hearing to review it.

Mr. Chairman, every study of the VA home loan guaranty program has shown the Congress that the program has worked well. It would seem that such an endeavor ought not to be radically altered in the absence of clear and compelling reasons. In that connection, I have noted that every major veterans organization is concerned about and opposes the Grace Commission's recommendation to drastically change the VA's method of handling foreclosures. Mortgage bankers also oppose the recommendation, and so does Fannie Mae.

Mr. Chairman, we hear predictions that this proposal will cause tight credit restrictions on veterans for GI loans. We hear of downpayment requirements where in most instances they do not exist. We hear from the Congressional Budget Office that savings occur only in the immediate years ahead and that then increased costs will occur in the outyears.

Mr. Chairman, it is good that the VA has been allowed to defer implementation of the Grace Commission's recommendation until at least October 1 of this year. It is also good that Harry Walters, the Administrator of the Veterans' Administration, has thrown up a red flag about this whole idea of VA dramatically changing a procedure that has worked well in the past.

For my part, I want to support the continuation of a program that is good for veterans, that is good for the economy, and is good for the Government. If there is a better way, I would like to hear about it. If there is a way to save money for the Government in the GI loan program without doing any injury to that program, I want to explore it. But, Mr. Chairman, I have yet to hear any reliable indication that the Grace Commission's ideas are plausible, that its economic projections are correct, or that its proposals would ad-

vance the cause of the Veterans' Administration's loan guaranty program for the veterans of our Nation.

Mr. Chairman, I look forward to the testimony of our witnesses this morning, and I again congratulate you for scheduling this important hearing.

Mr. SHELBY. Thank you.

Our first witness today will be Miss Dorothy Starbuck, Chief Benefits Director of the Veterans' Administration. Miss Starbuck, we are pleased to have you again before the committee and you may proceed as you wish.

Your written testimony will be submitted to the record, without objection.[1]

STATEMENT OF DOROTHY L. STARBUCK, CHIEF BENEFITS DIRECTOR, VETERANS' ADMINISTRATION, ACCOMPANIED BY JOHN P. MURPHY, GENERAL COUNSEL, AND ROBERT M. O'TOOLE, DIRECTOR, LOAN GUARANTY SERVICE

Miss STARBUCK. Good morning. It is a pleasure to meet with you this morning to discuss the operations of our loan guaranty program.

The gentleman on my left is Mr. Robert O'Toole, the Director of the Loan Guaranty Service, and to my right is Mr. John Murphy, the General Counsel of the Veterans' Administration.

The noted improvements in the Nation's economy are being reflected in relatively stable interest rates, and this stability has been accompanied by an increase in home purchases and a corresponding increase in the VA home loan program. During calendar year 1983, the number of certificates of reasonable value issued by the agency increased 67 percent over 1982, and the certificates of commitment increased 82.7 percent over 1982. If these rates remain steady, we would expect that our program would remain at its current level, or perhaps increase slightly.

One recent development in the housing area was the enactment last year of Public Law 98-181, which eliminated the authority of the Secretary of HUD to establish the maximum interest rate for most types of FHA insured loans. This legislation does not affect the VA home loan program, and we will continue to administer the maximum interest rate chargeable on VA guaranteed loans. In this, we will carefully monitor significant market indicators on a constant basis, and will continue frequent consultation with HUD's financial management staff.

We have introduced in the agency a number of innovations which have been inclined to increase productivity of our field stations. The prime example perhaps is the standard for approval of lenders authorized to underwrite VA guaranteed loans on the automatic basis. We have made revisions to this program to increase lender participation and have implemented a procedure which would also allow lenders to close refinancing loans on an automatic basis.

---

[1] See p. 39.

In December of 1983, over 46 percent of the VA home loans guaranteed were made on the automatic basis, compared to only about 20 percent a year ago.

As you know, Mr. Chairman—and you have mentioned the number of changes being considered for our loan program—these changes include the nonacquisition of properties, no vendee financing, and the sale of loans without recourse, and these are currently under review by an interagency task force. The Veterans' Administration, the FHA, the Farmers Home Administration, and OMB are participants in this task force. It is now too early to determine what recommendations will come from this group and what effect these recommendations will have on the insured and guaranteed loan programs.

Three other important factors I think I should point out concerning the operation of the loan guaranty program during this last calendar year should be noted. First, over 60 percent of the VA guaranteed loans were made without a downpayment from the veteran purchaser. Second, in the manufactured home loan program, veterans obtained almost 15,000 loans, which was a 43-percent increase over the prior and a new high for this program. Third, the loan program has assisted over 11.2 million veterans to obtain housing since the program was enacted in 1944. Mortgage credit totaling almost $221 billion has been infused into the economy, and much of this would not have been available without the benefit of this program. Over $79 billion worth of these loans have been repaid in full as of last year.

The benefits of the loan guaranty program are possible for America's veterans because the Congress did establish the loan guaranty revolving fund to pay for the program's expenses, exclusive of administrative costs. This fund has been significantly depleted during the last 3 fiscal years, and the unobligated balance remaining at this date will not be sufficient to meet the volume of claims we anticipate will be filed this year. Appropriations will probably be necessary if we are to honor claims submitted under the guaranty.

Mr. Chairman, we made only a total of 19 direct loans in calendar year 1983. Also, we found 405 veterans eligible for specially-adapted housing grants and granted those. Through 1983, over 18,000 veterans have been approved for grants, totaling $294 million. In October 1980, Public Law 96-385 was enacted, which authorized grants up to $5,000 to blind veterans and those who had lost the use of both hands to acquire adaptations for their homes. We have, through calendar year 1983, provided grants to 490 veterans, averaging $4,567 each.

Mr. Chairman, this concludes my summary, and we would be very pleased to answer any questions you or members of the subcommittee may have.

[The statement of Dorothy Starbuck appears at p. 39.]

Mr. SHELBY. Thank you.

It is my understanding that the President's fiscal 1985 budget proposed radical changes in operation of the loan guaranty program and that these changes in policy would have the VA pay the lender's full claim in every foreclosure case without regard to the value of the property securing the guaranteed loan. The CBO report on the loan guaranty program indicates that this change

would create some short-term savings; but that in the long run, this strategy would significantly increase costs to the Government.

Would you comment on how the policy changes presented in the budget will save or, on the other hand, cost the Government funds over a 5- to 10-year period?

Miss STARBUCK. Well, we would agree with the CBO analysis. It closely parallels our analysis, that, in fact, the program will significantly increase costs in the outyears. It is our estimate that in the year 1988 and 1989 the costs would escalate considerably.

Mr. SHELBY. Have you already met with representatives of HUD and Farmers Home Administration?

Miss STARBUCK. There have been two meetings, Mr. Chairman. The first I did not attend. It was attended by Mr. O'Toole. The second meeting I did attend and that was the first meeting at which the Farmers Home Administration was present.

Mr. SHELBY. Is there a consistent policy now in effect between HUD, VA, and Farmers Home on acquisition of properties?

Miss STARBUCK. No. We probably are operating on three different levels with respect to acquisition. Housing and Urban Development are just now implementing the legislation which permitted them to function in a manner similar to the Veterans' Administration's activities, and the Farmers Home Administration does have a selective decision to make with respect to acquisition of their properties. But there is no across-the-board policy as yet conceived.

Mr. SHELBY. Has there been any guidance at all from OMB, at these initial meetings, regarding the importance of keeping the VA loan guaranty program a beneficial program for veterans; or, on the other hand, is it a proposal that somebody is just looking at and saying "We can save some initial costs here; let's get it and move on"?

Miss STARBUCK. The guidance from OMB with respect to the programs is basically four things: There would be no acquisition of property following foreclosure, that there would be no sale of any acquired property using Federal funds, that any sale of loan portfolios would be done without recourse to the lender, and the fourth item was something new which was brought out at the second meeting, and that was to minimize any repairs to properties on which foreclosure had taken place and which had been acquired.

They are really aiming at what they term a minimizing of property acquisition.

Mr. SHELBY. Do you think these proposals by OMB would be in the best interest of the veterans of this country?

Miss STARBUCK. It would be difficult to see it in that light, Mr. Chairman.

Mr. SHELBY. The fiscal 1985 budget states that the VA experienced an average loss of $9,371 on properties sold in fiscal year 1983. Had the VA paid the full claim in each of these cases, however, the total loss would have averaged approximately $19,000. This means you would lose approximately $10,000 more on each piece of property if the proposal went through, as opposed to the present system. Is that about right?

Miss STARBUCK. The difference in those two figures, the 9 and the 19, would be an indebtedness established against the veteran on whom foreclosure took place.

Mr. SHELBY. In other words, a deficiency. Go ahead.

Miss STARBUCK. Let Bob clean up my act.

Mr. O'TOOLE. The difference, Mr. Chairman, between the 9 and 19 reflects additional costs that we don't now recognize in that process of making that decision on whether to acquire or not to acquire, such as primarily interest and administrative costs incident to the acquisition of the property and the resale of that property.

Mr. SHELBY. Thank you.

The Chair has no further questions at this time. I will now first recognize the ranking minority member, the Congressman from New Jersey, Mr. Smith.

Mr. CHRISTOPHER SMITH. Thank you, Mr. Chairman. I just have a couple of questions. Miss Starbuck, perhaps you could comment on this.

Have you heard back from any of your people out in the field, the loan guaranty officers, as to how they feel about the Grace Commission recommendations?

Miss STARBUCK. I think generally there is great concern throughout the field. Of course, the concern centers primarily with respect to the future of individuals who work in the loan guaranty program. They are tremendously concerned about how we might implement these changes in policy and the burdens that it would place upon the regional offices to quickly dispose of all properties that are in inventory. There is just a feeling of great concern about the outcome of this, and the fact that it is hanging in air is further disturbing.

Mr. CHRISTOPHER SMITH. It is my understanding that the Administrator has said that he will not implement this plan unless it becomes governmentwide. Is that still his position?

Miss STARBUCK. It certainly is. It certainly is, Mr. Smith.

Mr. CHRISTOPHER SMITH. One other question. If the foreclosure plan is adopted, could you comment on how it would affect the program? For instance, would it decline? Would lenders back out of the program?

Miss STARBUCK. All of the conversations that we have had since the Grace Commission Report was published is a feeling of very serious concern on the part of mortgage lenders about the future of the program as we know it today. There would be, in my judgment, great reluctance on the part of mortgage lenders to participate at the level at which they participate today. We would certainly anticipate their caution in risking capital would slow the loans to veterans.

Mr. CHRISTOPHER SMITH. One question for Mr. O'Toole.

Could you explain to the committee how FHA foreclosure procedures differ from the VA?

Mr. O'TOOLE. The current procedures, Congressman, are that FHA acquires every property that goes to foreclosure. Under their insurance program, they don't have any choice on whether to acquire or not to acquire. The law that was passed at the end of November last year allows them to prepare regulations that would allow some sort of decision-making process on whether to acquire or not to acquire.

Mr. CHRISTOPHER SMITH. Thank you very much for your answers.

Mr. SHELBY. The Chair next recognizes the gentleman from Tennessee, Mr. Sundquist.

Mr. SUNDQUIST. Thank you, Mr. Chairman.

I applaud these hearings, Mr. Chairman, and do want to comment that I think the Grace Commission has many parts that deserve consideration for reducing the deficit. I don't think——

Mr. SHELBY. If the gentleman would yield, I have to agree with him. I think there is a lot of good recommendations that we here in Congress ought to really heed that the Grace Commission has come up with. I just have to question this particular one.

Mr. SUNDQUIST. That's what I was going to say. I happen to agree with you and question this particular one. I don't think we can take all that has been recommended because this one doesn't make any sense to me. So I appreciate the opportunity to be a part of these hearings and I appreciate Miss Starbuck's testimony.

The VA finances part of the loan guaranty operation out of a revolving fund. There are some who think this fund is going to be out of money shortly. Do you think that is going to happen, and if so, what are the consequences?

Miss STARBUCK. We estimate that the fund will be depleted in about August. We have forwarded to the controller of the Veterans Administration our estimate of requirements for a supplemental in 1984.

Mr. SUNDQUIST. A followup question. We are going to have testimony today that recommends that the one-half of 1 percent fee on GI loans should be placed in the loan guaranty revolving fund. Would you comment on that, please?

Miss STARBUCK. There has been a proposal made in the Senate that would redirect one-half of 1 percent funding fee from the Treasury into the loan guaranty revolving fund. We have not yet been asked to comment on that.

Mr. SUNDQUIST. I would like to ask you to comment on it.

Miss STARBUCK. If this were a possibility, that would provide to the loan guaranty revolving fund about $80 million this year.

Mr. SUNDQUIST. How much?

Miss STARBUCK. About $80 million. That was about what was collected in 1982 and 1981. That would not make the revolving fund whole. We could not escape a supplemental appropriation for 1984 or additional appropriated funds in 1985.

Mr. SUNDQUIST. How much additional would be required?

Miss STARBUCK. The supplemental for 1984 is in the vicinity of $265 million. Now, that will do two things. It will allow us to complete fiscal year 1984 in the payment of claims, and have a startup figure of approximately $120 to 125 million going into fiscal year 1985. In fiscal year 1985, we estimate an appropriation requirement of roughly $500 million.

Mr. SUNDQUIST. Thank you.

Thank you, Mr. Chairman.

Mr. SHELBY. The Chair next recognizes the gentleman from Florida, Mr. Bilirakis.

Mr. BILIRAKIS. Thank you, Mr. Chairman.

I, too, commend you, sir, for calling this very important hearing. I have an opening statement, sir, that I would like to have inserted in the record.

Mr. SHELBY. Without objection, it will be included in its totality. [The statement of Michael Bilirakis follows:]

STATEMENT OF HON. MICHAEL BILIRAKIS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

I want to commend you for scheduling this hearing so promptly to discuss the Administration's proposal with regard to the VA home loan guaranty program, as well as other veterans housing issues pending before the subcommittee.

With the exception of medical care, the VA home loan program is perhaps the most important and popular benefit available to veterans. Purchasing a home of our own is the dream of every American, and this program assures that when it comes to buying a house, the veteran who stepped out of the private labor force to serve his country can stand on equal ground with his fellow citizens who were not obliged to forego employment advancement. I might add that shortly after my discharge in February, 1955 I used the program.

The VA loan program has worked well for 40 years, assisting more than 11.2 million veterans fulfill their dreams of home ownership, and sometimes, I think all of those veterans bought homes in my district. I'm exaggerating, of course, but one community in my District which has benefited from this program does come to mind. It's called Veterans Village and to the best of my knowledge, it is the only community of its kind in the country—an entire community of mostly single family homes planned specifically for veterans and their families.

Any proposal for significant change in the VA loan program must be assessed not just on its potential for savings to the government but first and foremost on its impact on the program's mission—to assist veterans in acquiring housing credit. Since the Administration's proposal to cease VA acquisition of properties at foreclosure was submitted, we have heard from many quarters regarding the negative impact such a change would have on the cost and availability of housing credit for veterans.

As I think we are all aware, the full Housing Veterans Affairs Committee has voted to put the necessary funding back in the fiscal year 1985 VA budget, based on the Administration's announcement that implementation of any policy change would be postponed pending the development of a government wide standard for property acquisition. While I am pleased with this development, I think it is nevertheless important for the subcommittee to look closely at this issue so we may be prepared to act wisely on any future proposal of a similar nature.

I want to welcome all our witnesses and thank you for coming. I look forward to your testimony.

Mr. BILIRAKIS. I would also like to say, sort of hitchhiking on my colleague from Tennessee's comments on the Grace Commission, that I think we all agree objectively that there are an awful lot of good things in the Grace Commission's recommendations. I might add that there is a gathering of Republicans who have formed a task force to analyze all of those recommendations and picking out the ones that we feel are good, with an effort to try to get them implemented. I am very pleased to say that virtually all of the recommendations that had to do with veterans have been taken out of our recommendations on the Grace Commission. In other words, we have agreed that we're not going to push those at all. I, frankly, can't see very many Members on the House floor voting to go along with some of the recommendations involving veterans. I am very pleased to say that our task force feels the same way.

I would ask Mr. O'Toole a question, basically because I'm not clear on this. The houses which are taken back by the VA, foreclosure situations, the VA now makes an effort to resell these homes, is that right, to recoup whatever it can?

Mr. O'TOOLE. Yes, sir.

Mr. BILIRAKIS. Now, what is the history as far as that is concerned? In other words, what does the VA generally have to resell these homes for, how much money is lost as a result of the resales

versus what it cost and that sort of thing? Can you give us a brief history? I think we need that information.

Mr. O'TOOLE. Historically, even in the resale of the properties we acquire as a result of foreclosure, we have taken a loss in money when you compare the difference between what we take to acquire and pay the claim and what we have been able to sell the property for. Overall, we're talking a number of properties. That figure currently is $9,700. That is a historical figure based on the amount we paid to acquire and pay the claim and the amount we have taken in.

Mr. BILIRAKIS. Why are we losing that kind of money, Mr. O'Toole?

Mr. O'TOOLE. There are some costs in there that we don't recover in the resale of the property. There are some administrative costs, the cost of selling the property, paying the real estate commission, paying the management fees while we have the property in our inventory, and there is the payment of the claim. Particularly, in times when interest rates have been fairly high, instances where the loan is in default for long periods of time, interest charges continue and that is part of the claim payment.

Mr. BILIRAKIS. Do we find much of a history of depreciation in the value? I realize that a home that maybe has been abandoned for quite a period of time is going to depreciate, at least physically.

Mr. O'TOOLE. That's what we're talking about, Congressman. We are talking about houses where the family has been unable to make payments, and by the time the property comes to us it hasn't had the maintenance and the upkeep that one would have when the family remains in the house and is making the payments.

And there are some costs involved necessary to put that property back on the market in a condition that will realize a sale.

Mr. BILIRAKIS. But are we satisfied that our procedures are adequate in terms of determining the value of those properties at the time that the loan is made, that the value is there at least during that period of time?

Mr. O'TOOLE. I think we are satisfied that the value is there at the time the property is sold. Our concern is that we want to look at the value of the property at the time of foreclosure. That is an area we think we should be looking at a little bit more closely and maybe needs some correction.

But as far as the value of the property at the time the original loan is made, I think we are satisfied that that valuation is being made properly.

Mr. BILIRAKIS. The valuation is made properly there, but we may——

Mr. O'TOOLE. In most instances. There certainly are some instances where that is not true. That is why we constantly review the work of the field appraisers on our panels, because that is something we certainly are concerned about.

Mr. BILIRAKIS. What sort of a default rate do we have, generally?

Mr. O'TOOLE. The current default rate, that being loans that are over three payments past due, it is 2.14 percent.

Mr. BILIRAKIS. How does that square with default rates with regular financial institutions, regular conventional loans?

Mr. O'TOOLE. It is below the FHA default rate and just a little bit higher than the conventional loan rate.

Mr. BILIRAKIS. It's a little bit higher?

Mr. O'TOOLE. Yes; I think the conventional loan default rate is currently about 1.9.

Mr. BILIRAKIS. Thank you, Mr. O'Toole, Miss Starbuck.

Thank you, Mr. Chairman.

Mr. SHELBY. The Chair recognizes the gentleman from Ohio, Mr. Applegate.

Mr. APPLEGATE. Thank you, Mr. Chairman.

I would agree with Mr. Bilirakis, that the Grace Commission is one that if we were to take at complete face value, with all of the provisions and recommendations, I think it would be a terrible thing, particularly for the Veterans' Administration, for the veterans, and I think the whole country itself would suffer because of it. While the purpose is to cut down on expenditures, in the long run there would be some very bad instances that I don't think we would want to see happen.

I have been in the real estate business and I do have a concern about the number of homes that are foreclosed on. There are literally thousands and thousands of them that the Veterans' Administration has foreclosed on. I know in my district there are many, many of them sitting there.

What kind of obligation does the Veterans' Administration have to these veterans for the sale of properties? Is there any particular length of time that you have to hold these properties? From the standpoint of depreciation and from the standpoint of interest, it would seem to me that if there was some commonsense injected into the disposal of these properties, rather than holding on to them for such long periods of time, they could save a considerable amount of money. Do you have to hold them for so many months or so many years? Some of them have been held for a number of years before there has been sales.

I have interceded on behalf of some people who have tried to buy some of these properties where it has not worked.

Miss STARBUCK. Mr. Applegate, there is no requirement that we hold a property any given number of months. The liability of the veteran with respect to the foreclosure is established at the time the foreclosure takes place. There are States, of course, who have State laws governing the homeowner's right to redeem his property within a period of perhaps 12 or more months, depending upon the State law.

We do in some instances recognize the fact that there are State redemption laws, but nevertheless sell a property that is within the redemption period. But there is no requirement that we retain a property. Our time of retention is totally governed by the market for procurement and purchase of those properties.

Mr. APPLEGATE. What is the average time of retention before you are able to get rid of those?

Miss STARBUCK. We are running about 10 months as an average time of retention with the current inventory.

Mr. APPLEGATE. That goes from area to area, and I suppose, depending upon the economics of the area and all that?

Miss STARBUCK. Yes, that would be true.

Mr. APPLEGATE. In my area, where there is a very high rate of unemployment and the economic times are little bit more precarious than others——

Miss STARBUCK. That is true, Congressman.

Mr. APPLEGATE [continuing]. Some of those homes are held for considerably longer periods of time. But there have been instances where they could have been sold but they weren't because the VA just wouldn't accept the offers on them. Of course, it isn't strictly because of the amount of money that the VA has invested in them, I'm sure, or does that have to be a consideration?

Miss STARBUCK. I am not familiar with the incident you are relating, Congressman. Are you, Bob?

Mr. APPLEGATE. Well, this is just general. There's a lot of them.

Mr. O'TOOLE. Congressman, we attempt to recoup whatever money we paid for the property and paid out in claims. Certainly, we can't get any more for that particular house than what similar houses are selling for in that particular neighborhood. But there is no requirement that we hold the property for a particular length of time. We want to turn that property over as fast as we can.

Mr. BILIRAKIS. Would the gentleman yield?

Mr. APPLEGATE. Yes, I will.

Mr. BILIRAKIS. I have two questions. First, does the VA try to mitigate its losses, particularly when it's a bad time to sell—and certainly last year was—by virtue of maybe renting them out?

Miss STARBUCK. We have some of them rented, Congressman. Not a lot, but some of them are rented.

Mr. BILIRAKIS. When you try to sell them, what do you do, list them with realtors?

Miss STARBUCK. Yes, they are listed with all realtors.

Mr. BILIRAKIS. You don't have auctions or anything of that nature?

Miss STARBUCK. We have not gone the auction route. It has been considered but we have not used that device as yet.

Mr. BILIRAKIS. Sometimes I think we would probably find that, if we took a little bit of initial loss, in the final analysis it wouldn't be as much of a loss because we then wouldn't have the depreciation continuing and the interest and lost interest and all that.

Mr. APPLEGATE. I was going to say, the VA pays managers to manage these properties in various areas.

Miss STARBUCK. That is correct, sir.

Mr. BILIRAKIS. Thank you, sir.

Mr. APPLEGATE. OK. I was just curious about the retention and the value of the property. Because in looking at some of them, I know that, just using one example of a $45,000 price tag on a house where the VA wanted that figure, and the best offer was at about $33,000 or $32,000—and I know the value of the property was about in that area—holding on to it to try to achieve that $45,000 figure just was going to cost the Veterans' Administration a great deal of money in the long run. That's why I was concerned about if they had any obligation to hold it for so long to try to get that money back.

Mr. O'TOOLE. It might be helpful, Congressman, to point out that we recently changed our procedures to allow us to take an offer that is below that price that we initially had the property on the

market for. The office now has the authority to set up a minimum price that they will accept, and if an offer comes in below the list price or above that floor, then they can accept that offer. So we think that is going to assist in the sale of some of these hard-to-sell properties.

Mr. BILIRAKIS. May I ask a question of the gentlemen?

Mr. APPLEGATE. Certainly.

Mr. BILIRAKIS. Why would the value be about $33,000 when, in fact, the balance owed was $45,000?

Mr. APPLEGATE. A very depressed or suppressed market.

Mr. BILIRAKIS. Not because it was overappraised, if you will, at the beginning?

Mr. APPLEGATE. It is a combination of factors, the economic conditions of the area and the deterioration of the property because of it being vacant.

Well, whether it was overvalued at the time of the sale, that cannot be said. But that is a possibility.

Thank you, Mr. Chairman.

Mr. SHELBY. The Chair now recognizes counsel for the committee, who has a number of questions on behalf of the chairman of the full committee, Mr. Montgomery. Mr. Mack Fleming.

Mr. FLEMING. Miss Starbuck, following up on a question asked by the chairman of the subcommittee, if we assume that the average loss now is approximately $9,400, and if we assume, based on the IG testimony before the Senate Veterans' Affairs Committee recently, that if the Grace Commission recommendation is implemented it would be around $19,000, where does that loss go? In other words, for the veteran to assume the additional loss? Is it going to be an additional debt that the veteran owes the VA?

Miss STARBUCK. Yes, it would, Mr. Fleming. That is basically one of our primary concerns.

Mr. FLEMING. Nothing has been said about this by the Grace Commission members or staff. They never mention the adverse impact that this is going to have on veterans. So if the Commission's recommendation is accepted, it will add about $10,000 worth of additional debt on the veteran.

What do you do to collect the debt?

Miss STARBUCK. Well, we treat this indebtedness like any other. As you are aware, our success in the collection of loan guaranty indebtedness is at an absolute minimum, because here we are dealing with an individual who, because of his financial situation, has lost his home, and his prospects for ever being able to recoup in the market at a sufficient level to be able to pay that indebtedness is very remote.

Mr. FLEMING. Let's assume the worst-case situation. Let's assume we're talking about a veteran who is 100 percent service-connected disabled, and he is drawing compensation at the rate of $1,255 or so a month, or whatever it is now. Do you offset the debt against the veteran's compensation payment?

Miss STARBUCK. We have the authority to do that, even without the consent of the veteran. However, it would not be my judgment that we would do anything other than enter into an agreement with the veteran so that his livelihood would not be impacted. If there could be some agreement that a portion of that compensation

could be withheld to apply to the debt, that would be an arrangement we could come to. It could well be that a veteran drawing 100 percent compensation has family responsibilities that would preclude his ever being able to come to an agreement with respect to repayment.

Mr. FLEMING. Does interest run on the debt?

Miss STARBUCK. Yes, it does.

Mr. FLEMING. At what rate?

Miss STARBUCK. The interest rate on that, I think we are still currently at 4 percent—or they may have increased it. I really don't know, Mr. Fleming. It has traditionally always been at 4 percent.

There is, however, in the assignment of rates of interest to debts against the Government, the current rate is 12 percent, and there is indication that that should apply to the loan guaranty indebtedness as well.

Mr. FLEMING. So, if the veteran has a debt of $19,000 and interest running on it at 10 or 11 percent, he may be unable to pay it off in his lifetime.

Miss STARBUCK. That is correct.

Mr. FLEMING. What if a young veteran loses his home this way and he comes in and would like to go to school under the GI bill; would this debt be offset against his GI bill benefits?

Miss STARBUCK. Yes it would be.

Mr. FLEMING. In other words, you could have a situation where he could be precluded from going to school because he lost his home due to circumstances beyond his control?

Miss STARBUCK. That is correct.

Mr. FLEMING. Let me ask a couple of questions about the revolving fund itself, because $500 million to replenish the fund, I think anyone would agree, is a large sum of money. But what has caused the depletion of the fund? Is it because of the unprecedented high default rates during the last 3 or 4 years?

Is that the reason it has depleted now to the degree that it is?

Miss STARBUCK. Yes, it is. The fund has had to have, in the last several years, support by transfer from the direct loan revolving fund. However, the direct loan revolving fund is now at a level where it can no longer be counted on to support the loan guaranty revolving fund.

But we have in these last 3 years seen an unprecedented rate of foreclosures due solely to the economic conditions in areas where hard industries have thrown so many people out of work and who have not then been able to meet their mortgage payments.

Mr. FLEMING. But are we asssuming that the high default rates are going to continue through 1989 and 1990? Is the situation not going to get better? The market seems to be a bit more active now.

Miss STARBUCK. Well, we have a pretty well-stacked pipeline in existence right now, Mr. Fleming. Hopefully, the rate of foreclosures will drop into this calendar year and on into 1985 and 1986. We look for some slowdown in that.

Mr. FLEMING. Up until now, has the revolving fund been self-sustaining. When was the last time appropriations were requested for the revolving fund?

Miss STARBUCK. Since the revolving fund was established, there has been no request for appropriations to the fund.

John?

Mr. MURPHY. I believe in 1962 or 1963 there was an appropriation, which was shortly after the loan guaranty revolving fund was set up.

Mr. FLEMING. The point is, if the revolving fund has carried itself through all of these years, and now 25 years later we're asking for an appropriation, that would not indicate that the home loan program has been a big money loser.

Mr. MURPHY. There have been transfers from the direct loan revolving fund, as Miss Starbuck mentioned.

Miss STARBUCK. Also, of course, we have had to sell about $2 billion worth of loans to investors in order to replenish the fund. But that source of money to the fund will be depleted as the current inventory of properties is sold and those loans, in turn, sold to investors.

Mr. FLEMING. One of the solutions seems to be to increase the loan origination fee and then to direct that the fee paid by the veteran go to the revolving fund. I don't know what the administration's view is of that, but would you support legislation directing the money to the revolving fund rather than to the Treasury?

I'm not asking you what OMB's position would be because we don't know. But in your view, would it not be better to have the veteran, if he is going to pay a user fee, to let it be used in order to help him during difficult times, rather than having the taxpayers fund it through appropriations?

Miss STARBUCK. From the agency's standpoint, we would. We did, when the fee was originally established. However, the decision was made that that fund would go to the Treasury. I would assume that the same position would be taken with respect to continuing the fee, or even increasing it.

Mr. FLEMING. Let me ask you one final question about the impact of the Grace Commission proposal on the lender. Nobody likes to defend the bankers or the lending institutions necessarily——

Miss STARBUCK. Oh, we think they've been pretty good fellows along the way.

Mr. FLEMING. It does seem unfair that OMB would come out with a new policy that would be retroactive. All of a sudden the lending institutions are told to forget what the assumptions were back years ago; we're now going to just pay off the guarantee and leave you, the lender, holding the bag. In other words, we're going to put you in the real estate business rather quickly.

Is this fair to the lender to make this retroactive?

Miss STARBUCK. Well, assuming the Grace Commission would prevail, yes, it would be retroactive. However, that is still a question that is being talked about in this task force that is meeting on the entire question.

Mr. FLEMING. Don't the lenders have a legitimate argument, that it is unfair to them to have to make loans based on certain assumptions and then be told to take the property and dispose of it themselves?

Miss STARBUCK. I am sure that's their perception, and they are justified in that perception, because what they have done is agreed, in about 60 percent of the cases that I mentioned, to finance a loan for a veteran who has not sufficient funds for a down payment. The guarantee has substituted for that down payment. But certainly, in 95 percent of the cases in which foreclosure has taken place, there has been strong reliance that the Veterans' Administration would take title to that property.

If we suddenly decide not to do that, you are correct, it does put the mortgage lender in the position of being a property owner, an owner of a property that has gone into foreclosure, and it would be his responsibility.

Mr. FLEMING. In your negotiations with OMB is any consideration being given to not making this new policy retroactive should it be implemented?

Miss STARBUCK. There has really been no great discussion because I don't think we're even at the point now where we could say we are ready to talk about retroactivity or proactivity on application of the policy. The policy has not been agreed upon among the agencies concerned.

Mr. FLEMING. Thank you, Ms. Starbuck.

Mr. SHELBY. I appreciate you coming up today, Miss Starbuck, and presenting your views and allowing us the opportunity to ask a lot of questions.

Miss STARBUCK. Thank you, Mr. Chairman.

Mr. SHELBY. Our next witness will be Kathleen Shepherd, senior budget analyst, Congressional Budget Office.

Miss Shepherd, we are glad to have you with us today. As usual, your written testimony will be submitted to the record, without objection, and if you could just basically sum up. We have had the benefit of your testimony, which I think is good, and I want to commend the Office for the job you have done here. If you would go ahead orally and present your testimony as fast as possible, because we have a lot of ground to cover. Thank you.

STATEMENT OF KATHLEEN W. SHEPHERD, PRINCIPAL ANALYST, CONGRESSIONAL BUDGET OFFICE

Ms. SHEPHERD. Thank you, Mr. Chairman. It is my pleasure to appear before the subcommittee today to discuss the operation of the VA's loan guaranty program and the future financial condition of the loan guaranty revolving fund.

The prospects of the fund over the next few years are uncertain because it is not clear under what set of policies the program will be operated. What is clear is that the ongoing effects of the recent recession on the fund have been severe. As you know, foreclosures of VA guaranteed home loans reached a historical high in fiscal year 1983, and they are anticipated to be even higher during 1984. Consequently, CBO anticipates a deficit of around $125 million in the revolving fund in 1984 if no changes are made in program operation. Additional deficits totaling nearly $1 billion are expected from 1985 through 1989 under present policies.

With the release of his 1985 budget, the President announced a series of administrative changes in the operation of the program

intended to address this situation. CBO has estimated that the administration's proposals would eliminate the deficits anticipated for 1984 and 1985 and would reduce the combined deficits in 1986 through 1989 by more than $280 million.

Over the last 6 months, CBO has also been studying the loan guaranty program. Our analysis indicates that an alternative set of changes would be less disruptive to program operations than the President's proposals and would result in an even greater reduction in the future deficits and outlays of the revolving fund.

These alternative options, which will be discussed in greater depth in a forthcoming CBO study, would prolong the solvency of the revolving fund through 1987. Whereas the changes proposed by the administration are estimated to reduce the fund's outlays by $500 million by the end of fiscal year 1989, the options examined in the CBO study would reduce fund outlays over the same period by $635 million.

CBO's alternative options reflect a different approach to many of the issues addressed by the proposals in the administration's budget. Our analysis indicates that the major inefficiency in the program's current procedures is that all loans under foreclosure and all real property available for sale by the VA are handled in a like manner. We have concluded that the financial position of the revolving fund would be significantly improved if the VA determined its course of action on each transaction by carefully weighing the financial consequences of all the alternatives available.

We examined a sample of 65 recent cases in which the VA had acquired a property as the result of a foreclosure. The circumstances surrounding both the foreclosed loans and the properties themselves varied enormously. The differences were so great that no single set of procedures for satisfying the guarantee or for disposing of the property would have been the best from the agency's perspective in all cases. Where the administration's proposals would substitute one set of procedures to be followed in all cases for another, CBO's options would focus on making the best economic choice between the alternatives in each case. For instance, when a VA-guaranteed loan is foreclosed, the agency could improve its comparison of the financial consequences of paying the guaranty or of acquiring and reselling the property by including all the costs of each alternative, particularly administrative and interest costs.

To sell the properties it has acquired, the VA need not always offer agency financing. Our analysis indicates that a significant number of properties could probably be sold for cash without a large reduction in the sale price. Since the VA vendee loan program has historically exhibited a default rate far in excess of the guaranteed loan program's, the use of VA vendee financing should probably be reserved for those cases in which the property is so undesirable that private lenders would be unwilling to finance the sale. In such cases, however, agency financing would probably bring a greater net return than a cash sale.

Together, the CBO options are estimated to reduce the loan guaranty fund over the next 5½ years by $635 million. By 1988, however, deficits should be expected, no matter how efficiently the program is operated, since it is the nature of this program to operate at a deficit.

This concludes my statement, Mr. Chairman. I would be pleased to respond to any questions you may have.

Mr. SHELBY. As I said earlier, I want to thank you for your proposed draft report. I thought it was excellent.

Of particular interest to me is your statement that if the VA makes a case-by-case comparison on the full financial consequences of all the alternative actions as proposed by CBO before acquiring foreclosed property, this could reduce the VA's 1984 to 1989 outlays by $635 million, a $128 million greater reduction than the administration's plan.

It is my further understanding that your proposal would continue to save money in the outyears, while still insuring a strong housing program for veterans, whereas the OMB proposal would have only short-term savings and would have a detrimental impact upon the VA loan guaranty program.

At what point in time do you believe that paying the guaranty in all cases of foreclosures on VA guaranteed loans would ultimately cost the revolving fund more than the current policy of always acquiring the property?

Ms. SHEPHERD. We have estimated that the cost effects of this policy would probably overtake the savings effects during 1987 or 1988.

Mr. SHELBY. I would also like to point out at this time that we will probably be submitting additional questions to CBO and also to the Veterans' Administration and others that might testify.

The gentleman from New Jersey.

Mr. CHRISTOPHER SMITH. I have no questions, Mr. Chairman.

Mr. SHELBY. The gentleman from Florida, Mr. Bilirakis.

Mr. BILIRAKIS. I don't know that I have any questions, Mr. Chairman. I will just refer to page 7 of the prepared remarks and ask if the range that you refer to there in your CBO sample of "$15,000 for a two-bedroom detached house in an economically depressed neighborhood in Detroit to a $90,000 high-rise condominium apartment in Los Angeles", whether that refers to VA loans in both instances?

Ms. SHEPHERD. No, sir, the values refer to the appraised values at the time of foreclosure.

Mr. BILIRAKIS. But they were not necessarily VA loans that were foreclosed upon?

Ms. SHEPHERD. No; they were not. In the case of the Detroit property, for instance, the loan was several years old, so the original principal amount of the loan was lower than——

Mr. BILIRAKIS. But that was a VA loan?

Ms. SHEPHERD. Oh, yes; these were both VA loans.

Mr. BILIRAKIS. And the $90,000 value, was that the value at the time of the foreclosure, at the time of the resale, or the initial value at the time of the initial loan?

Ms. SHEPHERD. That is the VA-appraised value at the time of foreclosure.

Mr. BILIRAKIS. You wouldn't know what that loan amount was?

Ms. SHEPHERD. I don't recall.

Mr. BILIRAKIS. I guess it sort of strikes me that $90,000 for a high-rise condominium is not something that I would ordinarily put in the picture of the need to acquire a VA loan.

Thank you, Mr. Chairman.

Mr. SHELBY. The Chair recognizes counsel for the committee, Mr. Fleming.

Mr. FLEMING. Miss Shepherd, on behalf of the chairman of the full committee, I want to compliment you on your statement. It will be most helpful to the committee. The chairman realizes how closely you have worked with the Veterans' Administration and the staff of this committee in putting your analysis together. It has an awful lot of merit and I was glad to hear Miss Starbuck say earlier that some of the proposals you are suggesting here are things the VA might want to consider. It is an excellent statement and I would like to tell you that on behalf of the chairman of the full committee.

Ms. SHEPHERD. Thank you, Mr. Fleming.

[The prepared statement of Ms. Shepherd appears on p. 47.]

Mr. SHELBY. Thank you for appearing before the committee and waiting patiently to testify.

Ms. SHEPHERD. Thank you.

Mr. SHELBY. Our next witnesses are Mr. Robert Mahn, senior vice president, Mortgate Operations, of the Federal National Mortgage Association, and Mr. Ronnie Wynn, president, Colonial Mortgage Co., and he is representing the Mortgage Bankers Association. Could both of you gentlemen come up together and we will try to take you as a panel.

Mr. Mahn, would you please lead off. Your written testimony, as I stated previously, will be submitted to the record. If you could just briefly sum up your position on this proposal by OMB, we would appreciate it.

STATEMENTS OF ROBERT J. MAHN, SENIOR VICE PRESIDENT, MORTGAGE OPERATIONS, FEDERAL NATIONAL MORTGAGE ASSOCIATION; RONNIE J. WYNN, PRESIDENT, COLONIAL MORTGAGE CO., MONTGOMERY, ALA., APPEARING ON BEHALF OF THE MORTGAGE BANKERS ASSOCIATION OF AMERICA, ACCOMPANIED BY BURTON C. WOOD, MBA'S LEGISLATIVE COUNSEL, AND WILLIAM E. CUMBERLAND, MBA'S GENERAL COUNSEL

Mr. MAHN. Thank you, Mr. Chairman. I will be as quick as I can.

Fannie Mae owns 450,000 VA loans, which is $11.2 billion, representing 11 percent of all VA home loans outstanding. These loans are secured by properties located in all 50 States, the District of Columbia, Puerto Rico, the Virgin Islands, and Guam.

I appreciate having the opportunity today to discuss the administration's stated budget policy for fiscal year 1985, which would change VA's practice of paying the full foreclosure claim amount and accepting title to the acquired property in most instances.

Because of the size of Fannie Mae's VA portfolio, this matter is of vital interest to us. We are particularly concerned about the retroactive effect of this change in policy.

Implementation of the administration's plan would be a most unfair and disruptive change. It will mean that all of our past VA

loan purchases were based on invalid assumptions. A change in the VA policy could mean that we would be faced with managing and marketing properties for 100 percent of our foreclosures instead of the 5 percent for which we are responsible. Using our 1983 experience, we estimate that over the next 3 years we would acquire an additional 7,800 properties as a result of this change. Our best estimates indicate that we would have to sell these properties for an average of at least 66 percent of their original value to avoid a loss. In many parts of the country, high incidents of vandalism, long redemption periods, stagnant real estate markets and declining property values make that goal difficult to attain.

The administration's position is based on the estimate of the Grace Commission recommendation that this change would affect 10,150 cases in the first year, saving the VA $68 million. That $68 million savings to VA represents a loss for the holders of the mortgages.

The obvious solution for avoiding these risks on VA loans is to stop buying VA loans altogether. Fannie Mae does not intend to do that. In fact, we believe that the planned change may create a greater need for us to be a purchaser of loans. The change could preclude the delivery of VA loans into the Ginnie Mae pools where most of them currently go. For loans in GNMA pools the lenders are required to advance money for foreclosures and they would be unwilling to do that in the future. Without the Ginnie Mae mortgage-backed security outlet, the cost of VA mortgage financing will be higher and some veterans with qualifying income today will be cut off from mortgage funds in the future.

No matter which of the various alternatives we choose to avoid these risks in the future, the Nation's veterans will bear the burden and will suffer the loss of benefits presently available by Federal law. Figures obtained from the Veterans' Administration regarding properties sold during the first 7 months of fiscal year 1983 indicate that the total loss per case averaged $14,400, including guaranty payments and all property management, selling, and carrying costs. The average guaranty amount for these properties was $19,000. By acquiring and disposing of the properties, the VA saved $4,600 per case, or a total of over $40 million. In view of the fact that the administration's planned policy change may cost the VA money, surely it should be subjected to further consideration and study by the Congress.

The current VA policy has functioned effectively over the years. It places no undue financial burden on either the veteran, the mortgage lender, or the Government. The planned change would be costly for veterans, for mortgage lenders, and, quite possibly, for the Federal Government. We question whether the change will provide the anticipated reduction in Federal expenditures.

It seems to us that the shortrun method to replenish the loan guaranty revolving fund is to aggressively dispose of the current inventory of 25,000 properties. Using VA's 1983 averages for sales price and related expenses, we estimate that this inventory has a net realizable value of about $750 million. Even if sold for a lesser amount, the proceeds would significantly restore the loan guaranty revolving fund.

In the longer term, with prudent underwriting, aggressive property management and marketing practices, and realistic bidding on foreclosed properties, the cost of this program could be significantly reduced. The answer does not lie, either in the short run or the long run, in adopting a policy of uniformly paying the guaranty in virtually almost all cases.

The Administrator of Veterans' Affairs has the authority to implement this new policy change without statutory change. In view of the significance of it, we believe it warrants congressional action. In our opinion, a change of such potential importance to the entire VA housing program should not be adopted by the Administrator without congressional sanction. We strongly urge that the VA's present policy be retained. It works, without unfairly penalizing any one sector or adding to the cost of housing for America's veterans.

Thank you, sir.

[The statement of Robert Mahn appears on p. 60.]

Mr. SHELBY. Our next witness will be Mr. Ronnie Wynn, president, Colonial Mortgage Co. He is appearing on behalf of the Mortgage Bankers Association. Mr. Wynn.

STATEMENT OF RONNIE J. WYNN

Mr. WYNN. Thank you, Mr. Chairman, and members of the subcommittee. My name is Ronnie Wynn. As the chairman said, I am president of Colonial Mortgage Co. in Montgomery, Ala., and I am also a member of the Executive Committee of the Mortgage Bankers Association of America.

We appreciate the opportunity to appear before you today to testify on the administration's proposal to discontinue acquiring properties after default, on H.R. 4685, a bill to increase the guaranty limits in the program, and on the VA home loan guaranty program generally.

MBA believes that the home loan guaranty program is an excellent one and that the VA has operated the program well. We oppose the administration's proposal to change the manner in which the program has been operated. We also oppose the proposal in the President's budget that the VA discontinue selling vendee loans with recourse. We support an increase in the maximum guaranty. We urge that the guaranty fee imposed on veteran borrowers be allocated to the VA rather than reverting to general Treasury funds. MBA urges that the maximum interest rates on VA loans not be administratively set and that interest rates on VA loans be negotiated freely. MBA also urges that the VA be authorized to guarantee mortgages with adjustable interest rates.

Included in the President's budget for fiscal year 1985 is a statement that the VA will make changes in the way that the VA loan guaranty program operates. This policy would change the current practice of acquiring title and disposing of the foreclosed properties. The current practice is more cost efficient for the taxpayers; it follows FHA procedure; it has encouraged active lender participation in the VA guaranty program since 1944; and it has enabled lenders and investors to make home financing available to veterans on better terms than are available in the conventional market.

The VA will not save money by paying the lender the guaranty amount in a foreclosure case. When the past experience of the VA is examined, it is clear that since 1979 the average loss on properties acquired and subsequently sold is about $10,000 less than if the VA had paid the average guaranty on those properties. The proposed change would cause a greater drain on VA finances than the current policy because VA's cash inflow will be diminished once the current inventory of properties is liquidated.

To require lenders to deal with property disposition would make VA guaranteed loans less attractive to lenders and increase the cost of mortgage credit to veteran borrowers. Vietnam era veterans, who are still entering the housing markets as first-time homebuyers, would be particularly hard hit by this proposed change.

The proposal in the President's budget would apply to all loans guaranteed by the VA, even those loans made by lenders over past years. To change the rules for loans already made would obviously be unfair to lenders, but it would also tend to discourage future participation in the Veterans' loan program because lenders, once burned, would naturally and understandably be reluctant to continue participating in the program.

The President's budget for fiscal year 1985 indicates that the VA will discontinue selling vendee loans with recourse. MBA is opposed to this proposed change in current practice. Sale of vendee loans without recourse will shift the credit risk of default from the VA to private purchasers, and purchasers will adjust their purchase prices accordingly. Because of its size, and because it is the lender, the Government is a more efficient manager of vendee loan credit risk than any private buyer can be. Therefore, it is highly likely that the reduction in the sales price paid by the private industry buyers of vendee loans will be greater than the savings the Government will realize by transferring the risk of default.

MBA supports an increase in the maximum amount of the VA home loan guaranty. In that connection, we would support H.R. 4685, introduced by Representatives Shelby, Montgomery, and Hammerschmidt to increase the guaranty from $27,000 to $30,000. As detailed in our prepared statement, an analysis of historical data would support an increase to $38,000. Such an increase would bring the relationship between the guaranty amount and the ever-increasing cost of new and existing housing closer to historical ratios.

MBA understands that the loan guaranty revolving fund will not be able to support the guaranty activities of the VA during 1984 and 1985 without additional appropriations. MBA applauds the action taken by the House Committee on Veterans' Affairs on March 8, when the decision was made to recommend that $108 million be restored to the fiscal year 1985 budget to assist in funding the VA home loan guaranty program.

MBA appreciates this opportunity to present our views, and we would be pleased to respond to any questions you have.

[The statement of Ronnie Wynn appears at p. 74.]

Mr. SHELBY. We appreciate both you gentlemen appearing. I will try to be brief here.

Mr. Wynn, appearing on behalf of the Mortgage Bankers Association, you stated that the implementation of the OMB proposal

will make VA guaranteed loans less attractive to lenders and increase the cost of mortgage credit to veteran borrowers. You further state that such a policy change would create an atmosphere in which veterans with VA guaranteed loans would be considered second-class citizens, in a sense.

Would you please elaborate on those statements?

Mr. WYNN. Under the VA guaranty program now, a lender can make a loan to the veteran for 100 percent, with the full faith and assurance that, the way the program operates now, in the unlikely event of a foreclosure, the lender would be made whole and his loan paid off. If we are put in the position that we would perhaps have to take the property back and dispose of it ourselves, the additional cost of creating that disposal system would raise the cost that we would have to charge to the lender, or raise the price of money to the veteran.

Mr. SHELBY. In a sense, it will just gut the VA loan guaranty program that the Congress has passed many years ago and implemented year to year?

Mr. WYNN. That is correct, Congressman. We think it is completely against the intent of Congress when they passed the bills for the benefit of the veteran intended.

Mr. SHELBY. Mr. Mahn, let me again commend you for your fine statement on behalf of Fannie Mae, the Federal National Mortgage Association.

In your statement you outline alternatives to which you might have to resort in order to minimize potential losses if this change in policy were to become effective. What do you believe the cumulative impact of these alternatives would be on the future success of the VA home loan guaranty program, or rather, do you think that many lenders would stop making loans to veterans or it would be a big change?

Mr. MAHN. As to the first question, I think the bottom line impact is going to be higher cost of housing to veterans, one way or another, and the exclusion of some veterans who presently qualify for loans from the VA program.

Mr. SHELBY. It would knock them out of the market, wouldn't it?

Mr. MAHN. Yes, sir.

The second part of the question had to do with how lenders would act. I feel certain that some lenders would withdraw from the program. As I indicated in my testimony, that would not be Fannie Mae's plan.

Mr. SHELBY. You would still have to react to reality out there, wouldn't you?

Mr. MAHN. We certainly would, and we would have to in some way adjust our pricing and fees in order to cover those losses. If the change were to be made retroactively, we would be in an especially difficult position because there would be no way to go back and adjust for the existing loans. We would have to make an adjustment going forward so that new applicants effectively would be covering not only the cost of their foreclosures but the cost of those that occurred previously. That would have to be one of the things that would have to be considered in order for us to be made whole.

Mr. SHELBY. I have talked to a lot of veterans and a lot of people representing the veterans' organizations. I know there are many

benefits the veterans' program offers. I never thought we gave the veterans anything. I always thought they had earned it, many, many times over. I believe this is the feeling of the majority of this committee and I hope in the majority of Congress. I would hate to see the demise of this program because what would come next? A home is very important to a veteran, as you well know.

The Chair next recognizes the gentleman from New Jersey, the ranking minority member, Mr. Smith.

Mr. CHRISTOPHER SMITH. Thank you, Mr. Chairman.

I want to congratulate both Mr. Wynn and Mr. Mahn for their very fine written statements, as well as their oral presentations here this morning.

I was wondering if either of you gentlemen or both have transmitted your concerns about the Grace Commission proposal to the administration, and if you have, have you received a response?

Mr. WYNN. We have transmitted them. Bill Cumberland, our General Counsel for MBA, will address the response.

Mr. SHELBY. The gentleman is recognized to answer the question.

Mr. CUMBERLAND. Yes, sir. The Mortgage Bankers Association did address its concerns to the administration in more than one letter, both to the Veterans' Administration and to the Office of Management and Budget, the White House. We recently have received a response from the White House, a four-page response, which we are studying now to try to determine what its contents——

Mr. CHRISTOPHER SMITH. Would you make that available to the committee?

Mr. CUMBERLAND. Certainly.

Mr. CHRISTOPHER SMITH. I would ask it be made a part of the record.

Mr. SHELBY. Without objection, if you will make that available, we will make it part of the record.[1]

Mr. BILIRAKIS. I wonder if their letters to the Grace Commission, Mr. Chairman, could also be a part of the record.

Mr. SHELBY. Yes. I would hope the Grace Commission letters and anything else will be made a part of the record and be furnished by the chairman of the committee to the other members of the subcommittee and the full committee.[2]

Mr. CUMBERLAND. Yes, Mr. Chairman, we will do that.

Mr. MAHN. Mr. Chairman, Fannie Mae wrote a letter to the Veterans' Administrator expressing our concerns, and we have received a response from him in which he indicated——

Mr. SHELBY. If you would transmit it to us, we would make this a part of the record, if you would, sir.[3]

Mr. MAHN. Fine.

Mr. SHELBY. Mr. Smith.

Mr. CHRISTOPHER SMITH. Mr. Mahn, on pages 3, 4 and 5 of your testimony you indicate that adoption of the Grace proposal would mean higher costs for the future GI homebuyers who would be required to absorb an additional financial burden to offset anticipat-

---

[1] See p. 101.
[2] See p. 91.
[3] See p. 112.

ed losses of their own loans as well as losses on loans now in your portfolio.

How much of an increased cost for an individual veteran do you anticipate?

Mr. MAHN. We haven't made a projection of that. We really haven't been able to fully evaluate the impact that this is going to have on us. The numbers here are rather elusive.

Mr. CHRISTOPHER SMITH. Is the organization working on that now?

Mr. MAHN. Yes, we are.

Mr. CHRISTOPHER SMITH. Mr. Wynn, do you have anything on that?

Mr. WYNN. The comparison I would make would be the historical relationship between a conventional loan and a Government-guaranteed loan, which is from 1 to 1½ percent interest higher charged for the cost of money on a conventional loan than on a Government-guaranteed loan. I think there would be some relationship to that.

Mr. CHRISTOPHER SMITH. One final question, Mr. Chairman, because we are pressed for time.

Mr. Wynn, in your testimony you say that, in your opinion, if the VA does not bid, that third parties also will not usually bid on foreclosed homes. Could you elaborate on that, since apparently the Grace Commission takes an opposite view?

Mr. WYNN. Third-party bidding would mean that real estate people would come into the picture to bid at the courthouse steps, if you will. There has been no historical record of any interest in this. The reasons, I would assume, are because of the interim financing that would be required by third parties and the availability and cost of that interim financing would be the primary reason that I don't think third parties would be involved, as well as the potential loss in not being able to judge what they could sell those properties for at a point in time.

Mr. CHRISTOPHER SMITH. Mr. Chairman, because of the time, I yield back the balance of my time.

Mr. SHELBY. Mr. Bilirakis, do you have a question?

Mr. BILIRAKIS. I will limit myself to just one quick one.

We have talked about your letters going to the Grace Commission and to the Administrator, et cetera. Did the Grace Commission coordinate with you, confer with you, particularly Fannie Mae, in any manner at all, in their deliberations and in their research in reaching their conclusions or recommendations?

Mr. MAHN. Yes. First let me say that we did not write to the Grace Commission and we are not expecting any response from them. But we were contacted during the course of their review. Some material that we submitted was utilized in that report, some comments. But, there's an error of fact in the report. We were quoted as saying we charge higher prices for VA mortgages because of these conditions. That is not so.

The contact was very minimal and really didn't contribute to the substantive decisions and recommendations of the Grace Commission.

Mr. BILIRAKIS. Do you know to what extent possibly they contacted the FHA or conferred with FHA on their viewpoints?

Mr. MAHN. I do not know that. I do not know.

Mr. BILIRAKIS. Thank you, Mr. Chairman. In the interest of time, I will cut it short.

Mr. SHELBY. Thank you. We appreciate you gentlemen coming up.

Mr. SHELBY. I know we have a number of people here from the various service organizations, and I am hoping that we can improvise and find enough chairs.

Mr. John Heilman, the national legislative director, Disabled American Veterans; Mr. Joseph Miller, assistant director, National Legislative Commission, the American Legion; Mr. James Magill, special assistant to the director, Veterans of Foreign Wars of the United States; Mr. Robert Moran, associate legislative director, Paralyzed Veterans of America; Mr. Dennis Rhoades, executive director of Vietnam Veterans of America; Mr. Richard Johnson, Jr., director of legislative affairs, the Non-Commissioned Officers Association of the United States of America; and Lt. Col. David Passamaneck, national legislative director, AMVETS.

Gentlemen, I am hoping we can improvise and get enough room at the table for you. I have been informed that we have a live quorum call. We will recess for just a few minutes and some of us are going to go over there and try to answer that call. I know I will come back, but some of the other gentleman have other hearings. If you all would just be at ease a few minutes.

[Whereupon, the subcommittee was in brief recess.]

Mr. SHELBY. The subcommittee will come to order.

Gentlemen, I apologize for bringing you all up together, but we have going on a joint meeting of the House and Senate and I think the Prime Minister of Ireland is going to address us. I am here with you all because I think we have a domestic situation here with the VA and we want to see it addressed and see that it is not destroyed.

Your written testimony will be submitted to the record, without objection, and be included in its totality. We would appreciate it if you would briefly sum up your remarks. I think all of you are concerned about what the OMB proposal would do. We understand this. I think you have a sympathetic group here, the members of the committee, who are going to work with the veterans' organizations here in the Congress, and that is why we are holding these oversight hearings today, to see what the proposal would do and what we can do to deliver the best housing program to the veterans of America. I think that is basically where you all are coming from, as I understand it.

Mr. Heilman, why don't you go first.

STATEMENTS OF JOHN F. HEILMAN, NATIONAL LEGISLATIVE DIRECTOR, DISABLED AMERICAN VETERANS; JOSEPH E. MILLER, ASSISTANT DIRECTOR, NATIONAL LEGISLATIVE COMMISSION, THE AMERICAN LEGION; JAMES N. MAGILL, SPECIAL ASSISTANT, NATIONAL LEGISLATIVE SERVICE, VETERANS OF FOREIGN WARS OF THE UNITED STATES; ROBERT MORAN, ASSOCIATE LEGISLATIVE DIRECTOR, PARALYZED VETERANS OF AMERICA; DENNIS K. RHOADES, EXECUTIVE DIRECTOR, VIETNAM VETERANS OF AMERICA; RICHARD W. JOHNSON, JR., DIRECTOR OF LEGISLATIVE AFFAIRS, THE NON-COMMISSIONED OFFICERS ASSOCIATION OF THE UNITED STATES OF AMERICA; AND LT. COL. DAVID J. PASSAMANECK, NATIONAL LEGISLATIVE DIRECTOR, AMVETS

STATEMENT OF JOHN F. HEILMAN

Mr. HEILMAN. Thank you, Mr. Shelby. I will summarize my remarks.

First let me say that the DAV does appreciate the fact that you are conducting these hearings. You and your subcommittee have been very active in the past several years on housing benefits for veterans. You passed a major bill last year on mortgage foreclosure assistance, which we supported, and, of course, you have some hearings in the near future on other aspects of the program. We do appreciate that.

I won't restate the policy, the subject of today's hearings, Mr. Chairman. We have heard from the previous witnesses and it is certainly true that the consensus is that it would be more expensive, would cost the VA more in the long term, to reverse their past policy of title acquisition and resale of guaranteed loans that have been foreclosed upon.

Mr. SHELBY. If you would yield to me for just a second, would it be a fair statement—I am trying to put together collectively a lot of your feelings—that what you're really interested in is saving and making the VA program work. You know, assuming there is merit in it, and I feel like there is, this program has worked in the past and maybe with some streamlining but not drastic changes it will work in the future.

Is this your basic feeling?

Mr. HEILMAN. Yes, sir; it is. "If it isn't broken, don't fix it." We certainly agree with that wholeheartedly.

I do want to touch upon one of the points made earlier, about the fact that if it is more expensive for the VA to do what is proposed, that we are increasing the indebtedness to the veterans themselves. Mr. Fleming brought that out in his questions.

Also, I do want to make the point that Public Law 96-466 that was approved several years ago did broaden the VA's authority to recover indebtedness and, in fact, requires the agency to recoup all indebtedness from the future benefits that beneficiaries may have. So it would be paradoxical to increase the indebtedness of the veteran in this fashion and then recoup that increased indebtedness from his benefits. You are compounding his precarious financial condition.

I want to make the point that the VA, though they would be compassionate in how they would do this and would attempt to work out an arrangement with the veteran that would do him the

least harm, the law does require them to recoup from benefits. I also want to point out that, lest someone might think that a waiver, either wholly or partially of the indebtedness, might be something that would come to the rescue, that is not necessarily true because the IRS recently has required the agency to gather data and provide it to IRS on indebtednesses that have been waived by the agency. IRS intends to regard such amounts as gross income and subject to taxation.

Mr. SHELBY. Have they passed a regulation on that yet?

Mr. HEILMAN. My understanding is it was an administrative decision, Mr. Chairman, that requires no action by the Congress or whomever, that they can do this and, in fact, intend to do it.

Mr. SHELBY. Do you all have a position on that? I know it's outside the scope of these hearings.

Mr. HEILMAN. I think it's a very, very bad idea. I think once you examine the people, the category who become indebted to the VA, and for what reasons, I think you would probably find, No. 1, that there might be a very insignificant amount of revenue impact coming in to the Government because these people are in precarious financial conditions. If they have a $1,000 or $2,000 indebtedness, for whatever reason, if you add that to their gross income you just might find that you're really not increasing tax revenues very much. At the same time you are certainly harming the veterans in question. We think it's a bad idea.

So let me just end by saying that, as has been pointed out, the Grace Commission has some very good suggestions in terms of how the Federal Government might save some dollars and how it might become more efficient and do things with less cost. The Grace Commission also has some very, very bad ideas, especially with respect to the VA, and this is one of them. We urge your committee, either through a negotiated agreement with the administration, or, if necessary, by the legislative process, to insure that the VA is not forced to implement a policy that is detrimental to the program and to veterans.

Thank you.

[The statement of John Heilman appears at p. 115.]

Mr. SHELBY. Our next panelist is Mr. Joseph Miller, assistant director, National Legislative Commission, the American Legion.

STATEMENT OF JOSEPH E. MILLER

Mr. MILLER. Mr. Chairman, I would like to also thank you for the opportunity to present our views today. We consider these hearings to be extremely timely and important.

Necessarily there is a great deal of redundancy in what people have been saying regarding the Grace Commission report. Material available to the Legion indicates that, in fact, the VA would over a period of time lose money as opposed to saving money, and that certainly is of concern to the Legion.

There are a variety of questions that we have that hinge upon the Grace Commission report. We see the VA home loan program as a program which has gradually tipped, from a program that is there absolutely to help veterans, to a program that is now more than just a veterans program, but is helping bankers and the real

estate community. Our written statement has provided a couple of points to assist in this committee's consideration. We request that you look at them.

I would also like to thank you for your attempt to gain home loan foreclosure relief and we would have one suggestion. Since the relief bill has passed the House, we hope that the Senate will quickly take action. We would, however, like to see the payback period extended beyond the 4 years in your bill, because it has been estimated that 40 percent of the veterans who would qualify under the program would be able to repay the VA. By extending the period of repayment, veterans would have a lower monthly repayment cost and the extension increase the amount of income to the VA. That could also help to offset the loan guaranty revolving fund deficit. So it is just something we think you might look at.

I will be happy to respond to any specific questions that you have. We have quite a few questions in regards to mortgage bankers' statement and some things that we see as relatively contradictory, but again, that is in our statement and you are certainly familiar with those questions.

[The statement of Joseph E. Miller appears at p. 122.]

Mr. SHELBY. We appreciate you appearing today before us.

Mr. James Magill, special assistant to the director, Veterans of Foreign Wars.

STATEMENT OF JAMES N. MAGILL

Mr. MAGILL. Mr. Chairman, thank you for the opportunity to present the views of the Veterans of Foreign Wars with respect to the VA home loan guaranty program. We consider this program one of the most utilized and beneficial programs administered by the VA and believe it should continue to enjoy the full support of the Congress and the administration.

We would, though, at this time like to voice our concerns over an administration proposal which would direct the VA in the future not to acquire foreclosed properties and the financial problems facing the revolving fund. Although the administration proposal would seem to be cost effective, as I pointed out in my prepared statement, we believe it is only a quick fix and would prove more costly in the long run, which has already been discussed.

We also believe the adoption of this proposal would make it more difficult for veterans to obtain home loans, especially Vietnam veterans, wanting to purchase their first home.

With respect to the financial problems of the revolving fund, we believe that the past economical conditions have played a key role in the current high acquisition of VA properties, and this high rate is a direct result. We also question the wisdom in making an across-the-board decision not to acquire properties in foreclosure when, in fact, these properties have been proven to be a viable source of income.

This concludes my statement and I will be happy to respond to any questions you may have.

[The statement of James Magill appears at p. 146.]

Mr. SHELBY. Mr. Robert Moran, associate legislative director, Paralyzed Veterans of America. Mr. Moran.

STATEMENT OF ROBERT MORAN

Mr. MORAN. Thank you, Mr. Chairman.

PVA, the Paralyzed Veterans of America, appreciates the opportunity to appear before you today. We would like to commend you for holding these hearings and personally thank each member of the subcommittee for their ongoing efforts to improve this program which affects so many of our Nation's veterans.

In summary, Mr. Chairman, while PVA was led to believe that the proposed October 1, 1984, implementation date for this new policy is tentative, we are uncertain whether such action should ever be taken. Several critical questions have not been answered satisfactorily by the administration regarding the potential effect such an action might have on our Nation's veterans.

If the proposal were to be implemented, will potential lenders be as willing to finance homes purchased by veterans? Will foreclosures be accelerated to the detriment of veterans? And will there be a resultant windfall of profits to be made by the private mortgage lenders and insurers at the expense of the veterans and the VA? These questions must be answered during consideration of this proposal. Veterans must not be used as a test to determine the viability and cost effectiveness of this proposal.

This concludes my statement. Thank you very much.

[The statement of Robert Moran appears at p. 153.]

Mr. SHELBY. Our next panelist is Mr. Dennis Rhoades, executive director of the Vietnam Veterans of America. Mr. Rhoades.

STATEMENT OF DENNIS RHOADES

Mr. RHOADES. Thank you, Mr. Chairman. VVA joins with the other organizations in expressing our appreciation for the concern of this committee over this critical issue. It is a key issue for our members, of course, as my friend from the VFW said. A lot of Vietnam veterans in particular are buying their first homes. If the Grace Commission and the first OMB recommendation ever did get through, it would have, we believe, a chilling effect upon the mortgage market and would possibly preclude a lot of Vietnam vets from ever owning their own homes.

Traditionally the VA has been a good way for a veteran to acquire his or her first home, and we would hate to see a system which has worked well for so many years all of a sudden thwarted in what I think is the congressional intent for the whole loan guaranty program.

We think it would be particularly ironic in light of the fact that we suspect much of the foreclosure problem is owing to the recession of the last several years. We feel it would be a cruel twist to dry up the mortgage opportunities for veterans, and especially Vietnam era veterans, now that the economy is improving. It would amount to a penalty against the veteran for circumstances which were beyond his or her control.

We appreciate your comments in particular, Mr. Chairman, when you referred to this benefit as an earned benefit. We believe it is.

VVA is also concerned about forebearance procedures governing foreclosures. Our written statement details a number of sugges-

tions we have concerning how forebearance procedures can be made consistent both by the VA regional offices themselves and by the lenders.

We have one other suggestion: many veterans' houses go into foreclosure because the veteran loses his or her job. This committee was wise enough in 1983 to pass the Emergency Veterans Jobs Training Act. We suggest that veterans who are identified as having foreclosure problems because of joblessness should be referred to the Veteran Services Division within the VA to see if we could get them into a job through Public Law 98–77.

That concludes our statement, Mr. Chairman.

[The statement of Dennis K. Rhoades appears at p. 160.]

Mr. SHELBY. Mr. Rhoades, I understand this is a new position for you, the executive director of Vietnam Veterans of America. Is this your first appearance?

Mr. RHOADES. I appeared twice over in the Senate. This is my first appearance before this committee.

Mr. SHELBY. Well, we want to welcome you. We hope that you're going to be around as long as you desire. You have a good group to represent here, the Vietnam Veterans of America, which has been so neglected.

Mr. RHOADES. We thank you, Mr. Chairman.

Mr. SHELBY. Mr. Richard Johnson, Jr., director of legislative affairs, the Non-Commissioned Officers Association of the United States.

STATEMENT OF RICHARD W. JOHNSON, JR.

Mr. JOHNSON. Thank you, Mr. Chairman. I, too, will attempt to be brief.

I would like to review for just a minute the program goals of the home loan guaranty program. The first goal—and there are only three—the first goal is to provide assistance to the veteran in acquiring a home, and that has worked 11 million times in the past 40 years. More than half the time, those guarantees have been provided to veterans who would not enjoy the benefits of home ownership otherwise, who would not have qualified for those loans. As a residual effect, the program has created econmic stimulus to the housing industry, it has created associated jobs and investment money, and it has created uncounted billions of dollars in community tax base structures all over this country.

The second goal was to provide assistance to the veteran in retaining a home, and the VA has gone about this in two ways; first by providing close oversight of underwriting practices, strict regulations on construction, and second, in working with the veteran to provide a system of counseling and other services to help each individual veteran retain his or her home.

The third goal was to provide the loan liquidation and property management while minimizing losses through a sound policy of acquisition, reseale, and payment of guaranteed amounts. Once again, the VA's record in this has been outstanding, as has been pointed out before this committee this morning.

Yet it is this portion of the system which the President's Private Sector Survey on Cost Control seeks to dismantle, and they are

doing this obviously without regard to the effects it would have on the other goals of the program.

As has been said, such changes will likely lead to stricter loan criteria for the veteran. Fewer veterans will qualify for home loan purchases. There is likely to be less forebearance on the part of lenders, when veterans do fall into default and ultimately foreclosure, and there are likely to be long-term losses in the loan guaranty revolving fund and an overall decline in the value of the program.

Finally, it would create a substantial debt—in fact, it would transfer virtually the entire debt to the veteran himself, as you pointed out just a moment ago. That probably is the most difficult part of these changes to accept.

As a result, and in summary, we believe that the acquistion policy that the VA has is sound and that it is designed specifically to preserve the current program. The current program is working well. The VA has demonstrated good stewardship of the taxpayers' funds in the way it has managed the program. Therefore, NCOA joins our colleagues here this morning in opposing any change in the loan guaranty program.

One final thing, Mr. Chairman. There has been a lot of talk about what happens when a debt is created on the part of the veteran. The VA, by average, collects about 17 cents of every dollar of debt created to the veteran, and now there is a proposal to report the other 83 cents of the dollar to the Internal Revenue Service. It is a bit absurd, a little ludicrous, and I really don't think it takes a wizard to see that if the veteran can't pay the VA that 83 cents, it's going to be very unlikely that he will be able to pay the tax on the amount. So even considering the transfer of this debt just further increases the deficit, the real dollar deficit. It just places it on the veteran himself. I think that's a bad alinement in the program.

I thank you, Mr. Chairman.

[The statement of Richard Johnson, Jr., appears at p. 169.]

Mr. SHELBY. Our next witness is Lt. Col. David Passamaneck. He represents AMVETS.

STATEMENT OF LT. COL. DAVID J. PASSAMANECK

Colonel PASSAMANECK. Thank you. Good morning, Mr Chairman.

AMVETS is pleased to have this opportunity to comment on the proposed change in VA loan guaranty policy which would, in effect, convert the VA into an insurer of the pro rata share of home loans rather than a vital cushion to absorb the shock of foreclosure for the benefit of both the mortgage industry and the veteran.

If the VA forces the lenders to assume the burden of carrying in their inventory the foreclosed properties which the VA now redeems and markets, not only will the cost to the Government on each transaction rise by approximately $5,000, but the cost of financing to the veteran will undoubtedly drive many, if not most, of the prospective veteran borrowers out of the ranks of homeowners. The no-down-payment loan may well be rare, if not entirely unworkable, if the VA stops acquiring foreclosed properties.

The only possible beneficiaries of this proposal will be the private sector writers of mortgage insurance, whose rates will go up.

Of paramount importance in the discussion of the Grace Commission's proposal regarding the VA loan guaranty program is the simple fact that the benefit or interest of the veteran did not fit into their calculations. Whatever can be said regarding the relative losses or savings to the Government or the mortgage industry, everyone agrees that the veteran will suffer.

This proposed change in practice completely ignores the Government's obligation toward its veterans as a continuing cost of war and national defense. Even if it could be argued that the Grace Commission proposal is consistent with efficient money-saving business practices, the proposal completely ignores the VA's role as a provider of earned service and entitlements to veterans rather than a profit-making business.

AMVETS appreciates the efforts of the Administrator of Veterans' Affairs to forestall the implementation of the change at least so long as all other Federal home loan programs are not required to stop acquiring foreclosed properties. We do not, however, accept the concept that the veterans' programs are to be evaluated according to the same criteria as other Government income transfer, guarantee, or benefit programs.

We take the position that national defense, including military compensation and veterans programs, come first in the allocation of Government resources and last in the cutting of budget deficits. The Office of Management and Budget and the Grace Commission put it just the other way around. According to Budget Director Stockman and Senator Laxalt, among others, the administration will not begin cutting veterans' entitlements until after the elections. With this proposed crippling of the loan guaranty program, it looks like they have started well before the elections.

This concludes my testimony.

[The prepared statement of Colonel Passamaneck appears on p. 178.]

Mr. SHELBY. I want to say, on behalf of the committee, we appreciate you coming up here. As chairman of the subcommittee, I am going to continue to work with you to see that we keep the VA housing program that works. We know it will work. Maybe it ought to be streamlined.

I want to recognize the gentleman from Florida, Mr. Bilirakis.

Mr. BILIRAKIS. Thank you, Mr. Chairman.

I welcome all of these gentlemen and commend them for all the great work they do on behalf of all of our comrades. I particularly would like to welcome Colonel Passamaneck, whom I met in New Port Richey, Fla. last year some time. And to Mr. Johnson, I may be the only Member of Congress who is a member of NCOA——

Mr. JOHNSON. Not the only one, sir, but one of few.

Mr. BILIRAKIS. I particularly welcome you, too, sir.

This committee, the overall Veterans' Affairs Committee, has been a joy. Quite frankly—I can't say that about all of them—particularly because it has been so nonpartisan. You know, we don't like to hear testimony which is partisan testimony but, obviously, we always do, particularly when you're on the minority side. But I think the bottom line of everything is that this program, changing the foreclosure picture, would just gut the VA home loan program. I am convinced of that and have been convinced of it. I didn't have

to have a hearing today to know that. We have got to keep that from happening, no question about it.

Obviously, it was part of a bipartisan, again, Grace Commission, and I guess they had a brush and painted things based on the way they maybe would run their particular businesses. Obviously, the Government in some ways should be run like a business, but certainly I would agree with our chairman, not in the area of veterans, very definitely, because they have sacrificed more than any other segment of our society and we can't treat them the same.

You know, I was talking with the chairman on the way over to the Capitol to cast our quorum vote, and we talked about a $110,000 loan, no down payment loan at 12½ percent interest. Of course, we didn't happen to have an amortization schedule in our back pockets, and I don't know if anybody in the room has one. I don't know what a monthly payment would be on something like that. Are there any realtors in the room? Do you happen to have one there, sir? I guess we're going to come up with an answer. But probably it would run close to something like $1,200 a month.

What is the guideline, something like 25 percent of your take-home pay should be allocated to maybe principal and interest on a home? So you're talking about a veteran having to make $4,000 a month net in order to be able to afford a $110,000 home.

I'm not saying that veterans ought to be relegated strictly to inexpensive homes, but I think we are talking for the most part of the boys who have given up their jobs and their families and that sort of thing and come home, just like I did in 1955. I acquired a VA home. It's the only way my family would have been able to have a home, the first and only home they have owned. There is no way I would have been able to afford a $110,000 home.

I'm just wondering. We all agree that deficits have to be reduced. We all agree that it should not be done on the backs of the veterans, although quite frankly, at all my town meetings, I hear everybody say we have got to reduce deficits, "but don't do at the sake of my pocketbook." So while something has to be done, I think we would all agree, that we cannot adversely affect this program.

You know, I'm just wondering, aren't we encouraging foreclosures when we, in fact, allow anybody—the chairman and I were talking about this, and I think we agreed that even on our salary we probably would not be able to afford a $110,000 mortgage at 12½ percent. Aren't we really encouraging foreclosures when we allow that type of a figure?

You know, if the well runs dry, all veterans are left without anything at all. It seems to me significant that we have got to maybe take a look at these things objectively and maybe make a few changes but not hurt the veteran at all in the process.

Your comments, please.

Mr. JOHNSON. Mr. Bilirakis, the amortization schedule on that, since you asked, is $1,173.98 per month, principal and interest.

Mr. BILIRAKIS. OK, approximately $1,200.

Mr. JOHNSON. But the problem here is we're looking at veterans perhaps with working spouses. I don't think the $110,000 loan is the average. The average, as I recall it, is somewhere around $74,000 for a veterans loan.

Mr. BILIRAKIS. And that's about the average home these days.

Mr. JOHNSON. That's right.

But we do have a small group of veterans, successful veterans, particularly in high cost-of-living areas where salaries are somewhat out of proportion to the rest of the Nation, who have the same problems of other young veterans in finding home ownership. Yes; they are in high salary ranges individually, or by combined income with spouse. They have the ability to afford these houses. Yet they have not had the years to accumulate large sums of cash to make down payments on these homes.

There may be some looseness in underwriting standards because lenders recognize that the VA is going to make up their deficit. But I tend to believe that the good we are doing in this program on behalf of those veterans, in somewhat special circumstances, outweighs that very, very small portion where a lender has overextended.

Mr. BILIRAKIS. You talk about the good, and you're right about that. Of course, I don't think we're doing anybody any good if we put them in a home and they end up having to lose it in a few months or a year or two. It does mess up their credit rating, and then they face the trauma of having to get up and move and everything of that nature.

Mr. JOHNSON. I don't think any lender is writing loans so loosely that he expects this is going to be default, this is not going to be a default, this may default, but I'm going to write it anyway because the VA is going to make good on it. I think that yes, there is indeed a lot of latitude given to veterans, much more than there is to the average conventional home buyer. But I sincerely believe that the good of the veteran is at heart in this issue, and if the veteran comes in and has sufficient income to make the monthly payments, he doesn't have the large down payment required to buy an expensive house, there really isn't anything wrong with that. I don't think lenders are going overboard in that area.

Mr. BILIRAKIS. No. I agree, if he has a sufficient income. I personally like very much the concept of no down payment or a very minimal down payment. I would not have been able to make one back in 1955, so I agree with you.

Mr. JOHNSON. Back in 1955 cigarettes were still a nickel a pack in the commissary and the Red Cross ladies came around on Sunday with the donuts and milk.

Mr. BILIRAKIS. But the salaries were also correspondingly——

Mr. MILLER. Mr. Bilirakis, I would like to respond to that, too, if I may, because the American Legion differs somewhat from NCOA.

First of all, over the last several years the percentage of income that can be devoted to a mortgage has risen from 25 to 36 percent. At the same time, you have people making these commitments where they may have upward of 32 to 33 percent of their income devoted to a mortgage. There have been astronomical increases in the cost of home heating oil and in gas for homes; you've had increases in electricity costs, and a concurrent increase in the cost of taxes, just property taxes in general.

When you start to see these levels compounding—and in 1982 the mortgage bankers wrote a letter to the chairman of the Senate Veterans' Affairs in which they stated that people were buying homes and their income was strapped, pushed to the limit. It does

not seem to the Legion to be good policy to make loans where people are going to be pushed to the limit. It seems to us that something needs to be done to moderate the way in which some of these loans are made.

We do not want to deny veterans loans, but at the same time we do not feel that it does the veteran, the Veterans' Administration, or the home loan program any good to make a loan to somebody who will potentially default. We feel that 100 percent indemnification, which is what the loan guaranty program, in essence, provides, is not the best vehicle for making the best loans. There ought to be some way to modify this indemnification somewhat so that it becomes a tool, a management tool, in assisting the program and making the program a better functioning vehicle for the veteran and for the acquisition of loans.

Mr. BILIRAKIS. Well, I appreciate your remarks, sir. I would hope that we all are open minded enough to maybe basically feel the same way. We can't hurt the program, and I think we probably all agree.

By the way, the VA representatives have stayed throughout the entire hearing, and that quite often does not happen in our hearings. Witnesses often testify and leave. I am very pleased to see that the people have stayed here.

Mr. SHELBY. If the gentleman would yield——

Mr. BILIRAKIS. But there is some efficiency certainly needed in that area.

Yes, sir.

Mr. SHELBY. I like what the gentleman is raising here. We want the program to work. I think you want the program to work for the veteran. So when we raise these points, would you look at some of the underlying problems or other problems? I know we are not looking at the VA program, and shouldn't look at it, as a conventional loan. That's what you have to differentiate. One of you used the phrase "earned" benefit. It is an earned benefit and let's keep it that way.

Mr. RHOADES. Mr. Chairman, one more point on the comment made by the American Legion.

There is half a percentage point difference between the foreclosure rate for conventional loans and the foreclosure rate for VA loans. I would be very cautious about attributing the difference solely to the perhaps easier credit standards that may govern VA loans, the modified income requirements. I would be very curious to know, for example, what percentage of the foreclosures were due to the veteran getting in over his or her head, what percentage were due to marital splitups, which I understand is a big factor in foreclosures, and what percentage is due to just plain, old, ordinary joblessness. I would say that before we rush in to trying to tighten up on the credit standards, we might want to look at what proportion it is of the whole foreclosure problem. Otherwise, it might have the effect of slamming a lot of doors in the faces of veterans who are capable of making payments, however tight their money is going to be over the short term.

Mr. BILIRAKIS. You raise a good point, sir, and I understand the Veterans' Administration runs periodic studies that would make that information available?

Mr. O'TOOLE. That's right.

Mr. BILIRAKIS. I would appreciate, sir, not only having that information in the record, but I would certainly like to personally have that.

[Subsequently, the Veterans' Administration provided the following information:]

The Veterans' Administration does not have any reliable data on the reasons for default on VA guaranteed or VA-owned loans. We believe, however, that the primary causes of these defaults have been loss of income resulting from unemployment or reduced employment, marital difficulties and over-obligation.

Mr. SHELBY. The gentleman from Florida raises a good point. I like what the gentlemen said on the panel a minute ago. I would like the information, and if you can get it, or if we can get counsel to obtain it for the members of the committee, the relative foreclosure rates on conventional loans and the HUD loans versus this, and why. I think you raise a good point.

Yes, sir.

Mr. MILLER. Mr. Chairman, the national delinquency survey, which is prepared by the Mortgage Bankers Association, is the document most frequently cited in regards to foreclosure and delinquency rates. What that document showed for the fourth quarter in 1983 was that VA loans had a delinquency foreclosure rate 1 percent lower than that for FHA and about 3 percent higher than conventional loans.

There is a problem with that survey, we feel. The survey deals with one- to four-family residential unit mortgages. Yet less than one-half of 1 percent of VA mortgages are for more than single family units. So we would like to know how many in the total conventional mortgage package, of all the mortages they're considering, are for more than single family unit mortages. That could considerably alter the foreclosure relationship. In fact, if we were to look at the survey and make these adjustments, it might be that the veterans foreclosure rate is identical, or it might still be higher.

Mr. SHELBY. That information would be interesting. We would like to get it and we will do our best to get it.

Gentlemen, again we appreciate your appearing before us today and staying with us. Thank you so much.

[Whereupon, at 11:15 a.m., the subcommittee was adjourned.]

APPENDIX

STATEMENT OF DOROTHY L. STARBUCK

CHIEF BENEFITS DIRECTOR

VETERANS ADMINISTRATION

BEFORE THE

SUBCOMMITTEE ON HOUSING

AND MEMORIAL AFFAIRS

COMMITTEE ON VETERANS' AFFAIRS

HOUSE OF REPRESENTATIVES

MARCH 15, 1984

Mr. Chairman and Members of the Subcommittee:

It is a pleasure to appear before you this morning to discuss the operation of the Veterans Administration's housing program. I have with me today John P. Murphy, General Counsel, and Robert M. O'Toole, Director, Loan Guaranty Service.

Improvements in the Nation's economy are being reflected in relatively stable interest rates. This has permitted VA to keep the interest rate on guaranteed home loans within the 11½ percent to 13½ percent range through all of 1983. The current rate of 12½ percent has been in effect since November 1, 1983. This interest rate stability has been accompanied by an increase in home purchases and a corresponding increase in the VA home loan program. During Calendar Year 1982, VA issued 393,618 certificates of reasonable value and 120,506 certificates of commitment to guarantee loans.

During Calendar Year 1983, the number of certificates of reasonable value issued increased 67.5 percent to 659,345 and certificates of commitment increased 82.7 percent to 220,154. If interest rates remain steady, VA loan volume can be expected to remain at current levels or increase slightly.

One recent development in the housing finance area was the enactment last year of Public Law 98-181 which eliminated the authority of the Secretary of Housing and Urban Development to establish the maximum interest rate for most types of FHA insured loans. This legislation does not affect the VA home loan program, and we will continue to administer the maximum interest rate chargeable on VA guaranteed loans. In carrying out this responsibility, we will make every effort to avoid any significant departure from past rate-setting practices. As long as the statute charges VA with the duty to set a maximum interest rate, we consider it important to closely regulate such rate. It is only through orderly and timely rate changes that we can successfully moderate the cost of home financing for veterans and still minimize the amount of discount points lenders must charge.

To this end, we will be carefully monitoring significant market indicators on a constant basis. We will also continue our frequent consultations with HUD's financial management staff whose expertise and extensive market survey activities will be most helpful in our efforts to effectively administer the VA interest rate.

A number of innovations have been introduced, Mr. Chairman, to improve productivity of field stations. For example, standards for approval of lenders authorized to underwrite VA guaranteed loans on the "automatic basis" without VA reviewing the income and credit of the applicant prior to loan closing have been revised to increase lender participation in this program. We have also implemented a procedure which will allow the closing of refinancing loans on the automatic basis using a national index method for establishing the maximum loan discount a veteran may pay. This allows refinancing loans, including interest rate reduction loans, to be closed by eligible lenders using the automatic procedures. In December 1983, over 46 percent of VA home loans guaranteed were made on the automatic basis compared to approximately 20 percent during 1982. We will continue to streamline and improve processing procedures to allow for approval of GI loan applications in a manner which is quick and efficient while still protecting the interests of veterans and the Government.

As you know Mr. Chairman, a number of changes are being considered for our Loan Guaranty Program. These changes, including the non acquisition of properties, no vendee financing, and the sale of loans without recourse are being studied by an interagency task force. The task force is developing uniform Federal standards for determining when it would be in the best interests of the Government to acquire properties in Federal housing programs. VA, FHA, the Farmers Home Administration of the Department of Agriculture and OMB are the participants in this task force. It is

too early to determine the recommendations of this group and what effect these recommendations will have on the VA Home Loan Program.

During the year ending January 1984, the total number of Loan Guaranty field station employees increased from 1,903 to 1,997, a 4.9 percent increase. We expect to be able to continue to effectively perform the mission of the program with our currently authorized staffing levels.

Three other important facts concerning the operation of the Loan Guaranty program during Calendar Year 1983 should be noted. First, over 60 percent of VA guaranteed loans were made without a down payment from the veteran purchaser. These no down payment loans had an average purchase price and loan amount of $57,299. For those veterans who obtained loans with a down payment, the purchase price averaged $81,128 with an average loan amount of $69,281.

Second, in the manufactured home loan program in Calendar Year 1983, veterans obtained 14,872 loans, a 43 percent increase over the prior year and a new high in manufactured home loan financing. The average purchase price for manufactured homes was $21,753 with an average loan amount of $21,020.

Third, the VA loan program has assisted over 11.2 million veterans to obtain housing since the program was enacted in 1944. Mortgage credit totaling almost $221 billion has been infused into the

economy; much of these funds would not have been available without the benefit of this GI Bill program. Over $79 billion worth of these loans have been repaid in full as of last year.

The benefits of the VA Loan Guaranty program are possible for America's veterans because the Congress established the Direct and Loan Guaranty Revolving Funds to pay for the program's expenses except administrative costs. The Loan Guaranty Revolving Fund has been significantly depleted during the past 3 fiscal years. The unobligated balance in the fund will not be sufficient to meet the volume of claims we anticipate will be filed this year. Appropriations may be necessary if we are to honor claims submitted under the guaranty.

Mr. Chairman, the VA made a total of 19 direct loans in Calendar Year 1983 totaling $574,695. Sixteen of these loans were made to veterans also receiving specially adapted housing benefits.

Three were loans which had been "in the pipeline" at the time of the cutoff of the general direct loan funds. Construction or title problems prevented loan closing or full disbursement of the loans until recently.

Mr. Chairman, I am sure the Subcommittee would also be interested in receiving information about the Specially Adapted Housing Program for the severely disabled veterans. In Calendar Year 1983, 405 veterans eligible for the maximum $32,500 Specially Adapted Housing Grants were approved for such grants. Through

Calendar Year 1983, 18,739 veterans have been approved for grants totaling over $294 million. In October 1980, Public Law 96-385 was enacted which authorized grants up to $5,000 to blind veterans and those veterans who had lost or lost the use of both hands to acquire adaptations for their homes. Through Calendar Year 1983, 490 veterans have received such grants averaging $4,567 each.

Mr. Chairman, this concludes my statement. I will be pleased to respond to any questions that you or Members of the Subcommittee may have.

Written Committee Questions and Their Response

Hon. Christopher H. Smith to Veterans' Administration

Question 1. The 1985 budget reflects over a $100 million dollars savings as a result of this proposal. Do you agree with that estimate? If the plan is not implemented, would this require that a new budget request be made by the Office of Management and Budget?

Answers. The policy changes specified in the budget are now under review by a task force of housing agencies and OMB. This task force is attempting to develop uniform policies Government-wide regarding acquisitions of properties securing guaranteed, insured and direct loans. It is too early to tell if the final recommendations of the task force will necessitate a revised fiscal year 1985 budget for the loan guaranty program.

Question 2. The Veterans' Administration Inspector General has testified before the Senate Veterans' Affairs Committee that the Grace Commission proposal would ultimately be more costly to the Government. Has the IG's testimony received any reaction at O.M.B.? Do you know if the I.G. at HUD has made any findings in this regard?

Answers. OMB has been provided a copy of the VA IG report. We have not received formal comments from OMB concerning this report. Also, we are not aware of any similar review made by the HUD IG.

Question 3. You finance part of your loan guaranty operation out of a revolving fund. Our testimony this morning indicates that the fund will shortly be out of money. If that happens what are the consequences?

Answers. In the event that the loan guaranty revolving fund became insolvent, it would have a serious effect upon the loan guaranty program. VA would not be able to pay claims submitted by lenders of foreclosed GI loans and, in effect, fail to honor a guarantee made by the U.S. Government. This could bring into serious question the integrity of the Veterans' Administration. It also could inhibit future operations because lenders may be reluctant to make new GI loans if there is some doubt about VA's ability to honor its commitments in a timely manner. In addition, VA would be unable to meet ongoing expenses associated with the management and disposition for acquired properties, and could incur interest penalties under the provisions of Public Law 97-177, the Prompt Payment Act.

Question 4. Has the Administration reacted as yet to the suggestion over in the other body that the fee for GI loans be increased to a full one percent and that the funds collected go into the loan guaranty revolving fund?

Answers. The Administration has not taken a position on S. 2391.

Question 5. Do you still anticipate losing 136 employees in 1985 in your loan guaranty program as a result of this proposal even though it is now the subject of reexamination?

Answers. Presently, representatives from OMB, VA, FHA, and FMHA are working to develop uniform procedures regarding property acquisition in Federal housing programs. The impact of policy changes resulting form this task force are not known at this time. When policy changes are uniformly established, we will review the employment requirements necessary to staff the loan guaranty program in FY 1985.

Question 6. Does FHA currently repair foreclosed houses before they go on the market?

Answer. It is our understanding that FHA does repair some of their acquired properties. However, we suggest that specific information on FHA repair policies be obtained from the Department of Housing and Urban Development.

Question 7. When you sell your accounts to investors what is the usual price that they pay? What would they pay if you didn't agree to buy back the loans that go bad?

Answer. Loans are sold in competitive auctions at prices reflecting the secondary mortgage market conditions at that time. Older, low coupon loans bring lower prices than new higher rate loans. The bid prices are calculated to provide investors with yields commensurate with other mortgage type investment securities available at that time.

We feel that any offers made on loans sold without a repurchase agreement would be significantly lower in price.

Question 8. After you have sold your foreclosed houses and then sold you accounts to large investors, you repurchase those houses when they go into default. I understand that the Grace Commission has suggested that you stop this practice. What would be the effect if you stopped repurchasing the houses?

Answer. Vendee loans sold without the repurchase guarantee would be a very different product—one without a well established market such as we have now. The loans would no longer be eligible for inclusion in pools for GNMA mortgage-backed securities. We believe that there would be fewer interested bidders, and any offers to buy would be at substantially lower prices.

Question 9. What is your default rate on vendee accounts?

Answer. The vendee loan default rate as of December 31, 1983 is approximately 3.2 percent. This represents those loans reported as being delinquent more than three months as a percentage of vendee loans outstanding. In addition to those loans held by VA, this figure also includes loans sold with a repurchase agreement which are currently held by private investors.

Statement of
Kathleen W. Shepherd
Principal Analyst
Congressional Budget Office

before the

Subcommittee on Housing and Memorial Affairs
of the
Committee on Veterans' Affairs
United States House of Representatives

March 15, 1984

Mr. Chairman, I am pleased to appear before your Committee today to discuss the current condition of the Veterans Administration (VA) loan guaranty program and the outlook for the coming years. As you know, the main function of the VA's Loan Guaranty Revolving Fund (Guaranty Fund) is to guarantee veterans' residential mortgages for 60 percent of their principal value up to $27,500. As of the end of fiscal year 1983, the VA had guaranteed some 11.5 million loans with an aggregate value of $200 billion.

A FUNDING PROBLEM

The Congressional Budget Office projects that, under current policies, the Guaranty Fund will have a negative balance of $127 million by the end of this fiscal year. By the end of 1989, shortfalls are projected to exceed $1 billion. Two main problems account for this poor prospect for the Guaranty Fund:

- Unprecedented default rates on VA mortgage loans in the wake of the recent recession, and

- Loss of the external support that has traditionally helped to keep the Guaranty Fund afloat.

Defaults

The costs of a VA loan default fall to the Guaranty Fund, whose role it is to provide restitution to the lender (commonly some private lending institution) either by paying off the guaranty or by purchasing the property. When the VA purchases a property, it then attempts to resell it, offering the new purchaser a direct mortgage, or "vendee loan." Receipts from the property sale or from the subsequent sale of the vendee loan are deposited in the fund. In general, the VA loses money as a result of property acquisitions and subsequent resales. The current record-high defaults, a consequence of the recent recession, are thus one source of extreme pressure on the Guaranty Fund.

Loss of Past Subsidization

In the past, when shortfalls occurred in the Guaranty Fund, another VA account--the Direct Loan Revolving Fund (Direct Fund)--has provided the cash needed. Thus far, the Direct Fund has contributed nearly $2 billion toward the support of the Guaranty Fund. Now, however, this recourse is no longer available. Partly as a result of recent administrative budget-cutting measures, the Direct Fund is radically reduced in scale and purpose. Past transfers to the Guaranty Fund and liquidation of assets have depleted the Direct Fund. The VA therefore expects further subsidization by the Direct Fund to be impossible, at least for the near future.

FUNDING OPTIONS FOR FISCAL YEAR 1984

The immediate situation indicates that prompt action is necessary to assure the Guaranty Fund's ability to keep its 1984 commitments. The VA has indicated that it may request a special supplemental appropriation to cover the Guaranty Fund's 1984 obligations. In addition, the Senate Committee on Veterans' Affairs has ordered reported S.2391, a bill that would increase the fee charged for home loans made or guaranteed by the VA. Under S.2391, this so-called "origination fee"--first implemented in 1983 and scheduled to end in 1985--would rise from one-half of 1 percent of the loan principal to a full 1 percent. The bill would also require that origination fees be deposited in the Guaranty Fund between March 31, 1984 and September 1985; under current law, fees are returned to the Treasury. If the Congress enacted S.2391 immediately, the Guaranty Fund's 1984 shortfall would be decreased by $90 million. Together with a small supplemental appropriation, this would alleviate 1984 funding problems.

OPTIONS FOR 1985-1989

The prospect for an accumulated deficit of $1 billion in the Guaranty Fund by 1989 clearly signals a need for farther-reaching solutions. One approach would entail changes to reduce the Guaranty Fund's future operating costs or increase its collections through improved operating efficiency. Two operating strategies CBO has examined are:

- The Administration proposals, and

- An approach that would improve financial comparisons underlying individual VA decisions.

A principal distinction between these approaches is that the Administration's plan, like current policy, would have all default cases handled in a single, uniform manner, whereas an improved case-by-case determination basis would accommodate the often pronounced differences among cases.

Neither of these operating strategies would entirely eliminate the Guaranty Fund's deficits, however. So I will also discuss other options for financing the Guaranty Fund's deficits.

Possible Operating Changes

The Administration's Proposals. In its budgetary request for fiscal year 1985, the Administration proposed a number of changes in the operating procedures of the VA's mortgage program. Two major features would provide:

- That the VA no longer acquire a property at foreclosure but instead pay the lender the amount of the guaranty applicable to the foreclosed loan, and

- That the VA would no longer offer its own financing (vendee loans) for the resale of properties acquired from foreclosures.

In addition, the Administration proposes that the VA stop offering repurchase agreements on sales of vendee loans already in its portfolio, and that the VA no longer purchase from the lender a guaranteed loan in default--a provision designed to grant the veteran-homebuyer special forbearance.

The changes proposed by the Administration--though they would result in an outlay savings of about $500 million over the 1984-1989 period--would merely substitute one single course of action for another. Moreover, while conferring some immediate benefits, this plan might have undesirable long-run characteristics. Paying the guaranty in all VA foreclosure cases would ultimately cost the revolving fund more than the current policy of acquiring properties. Historically, the average amount payable under a VA guaranty is larger than the average net loss experienced by the VA on an acquisition and resale. Initial reduction in outlays would thus be more than offset in later years by the subsequent elimination of collections from the sale of the properties and related vendee loans.

Improved Financial Comparisons. The CBO analysis indicates that the major inefficiency in the VA loan guaranty program's current operating procedures is that all loans under foreclosure and all real property available for sale by the VA are handled in a like manner. CBO has concluded that the VA can only maximize its financial position on transactions of this program if it makes a case-by-case comparison of the full financial consequences of all alternative actions. CBO estimates that this approach could reduce the VA's 1984-1989 outlays by $635 million--$128 million more than the Administration's plan.

In the past, the cost comparisons made by the VA have virtually always led it to conclude that it should acquire a property. But these comparisons have been based on estimates of acquisition costs that are systematically underestimated. With more complete cost accounting, two effects could reasonably be expected: the VA would pay the guaranty instead of offering to acquire the property in about 10 percent of all foreclosure cases; and in those cases in which the VA did offer to acquire, the price it specified to the lender would be lowered. CBO has estimated that this relatively minor change in VA procedures could reduce 1984 outlays by about $110 million. From 1985 through 1989, outlays would be further reduced by more than $200 million.

CBO has examined a sample of 65 recent cases in which the VA had acquired a property as the result of a foreclosure. (Details and analysis of

this study will be provided in a forthcoming CBO paper.) Among these cases was one in which the appraised value of the property at the time of foreclosure was less than 50 percent of the amount the VA had paid the lender to acquire it. In a contrasting case, one property had an appraised value 20 percent higher than the VA's initial cost of acquisition. In such discrepant cases, no single approach--neither acquiring the property nor paying the guaranty--would minimize the cost of satisfying the VA's guaranty.

Similarly, no single approach is appropriate for decisions about disposing of properties acquired at foreclosure. The properties in CBO's sample ranged from a $15,000 two-bedroom detached house in an economically depressed neighborhood in Detroit to a $90,000 high-rise condominium apartment in Los Angeles. While a vendee loan would probably not significantly increase the selling price of the Los Angeles condominium, whether the Detroit property could be sold at all without a vendee loan is doubtful. CBO's analysis indicates that larger net savings could be obtained by offering for sale without vendee financing those properties likely to sell for cash and by tightening the credit standards applied to those vendee loans that are needed to sell the remaining properties at a reasonable price. If the VA limited vendee financing to those properties that would not be expected to qualify for other mortgages, CBO estimates that $280 million could probably be saved between now and 1989. Tightening credit standards on vendee loans would bring the estimated savings associated with these improvements

in the financial management of the Guaranty Fund to $635 million through 1989.

Clearly, however, none of these options--including the Administration's proposed changes--promises to put the Guaranty Fund on a sound and self-sufficient footing permanently. As Table 1 shows, with any of these measures in effect, the fund would again be in a deficit position before the end of the 1984-1989 projection period. CBO has therefore considered strategies for funding the recurring shortfalls.

FUNDING OPTIONS TO CLOSE REMAINING DEFICITS

Remaining deficits in the Guaranty Fund could be financed either by:

- Extending and crediting loan origination fees to the Guaranty Fund rather than to the Treasury, or
- Appropriating the money needed directly or indirectly to the Guaranty Fund.

In considering the merits of these choices, the Congress would confront a necessary choice between general taxpayer financing and specific user financing. The appropriation approach would continue general taxpayer support for the VA mortgage program. Relying on income from origination

TABLE 1. FUNDING REQUIREMENTS OF THE VA LOAN GUARANTY REVOLVING FUND UNDER ALTERNATIVE APPROACHES, 1984-1989 (In millions of dollars)

	1984	1985	1986	1987	1988	1989	1984-1989
Funding Requirements Under Current Policies (Baseline)	127	109	9	180	301	384	1,110
Cost Impact of Administration's Proposals (Savings (-)/Costs (+))	-360	-264	161	63	-38	-90	-528
Remaining Funding Needed	0	0	0	25	263	294	582
Cost Impact of Improved Financial Comparisons (Savings (-)/Costs (+))	-207	-193	-18	-46	-80	-103	-647
Remaining Funding Needed	0	0	0	0	182	281	463

fees would alter the program fundamentally, making it a user-supported service. The current imposition of origination fees represents a temporary partial step in this direction. The choice between these alternative approaches would be influenced largely by whether the Congress continues to regard homeownership assistance for veterans as an aspect of compensation for military service that is properly supported out of general tax collections.

Origination Fees

As I noted earlier, S.2391 would increase the origination fee to 1 percent of the loan principal and would deposit the fees in the Guaranty Fund as of April 1, 1984. This measure would reduce the 1984 fund deficit to $37 million and would eliminate the deficits expected in 1985 and 1986 (see Table 2). Without an extension of the termination date, however, the fee hike would not affect the Guaranty Fund's deficits after 1987.

Alternatively, the Congress could extend the collection of fees beyond the 1985 termination date at the current one-half percent level or at the increased 1 percent level suggested by S.2391. The collections that would be expected under these options are also shown on Table 2. Crediting a permanent 1 percent origination fee to the Guaranty Fund would bring in sufficient collections to ensure the fund's solvency through 1989 with no other change in law or program operations. After 1987, however, the annual

TABLE 2. EFFECTS OF ORIGINATION FEE OPTIONS ON REQUIREMENTS OF THE VA LOAN GUARANTY REVOLVING FUND, 1984-1989 (In millions of dollars)

	1984	1985	1986	1987	1988	1989	1984-1989
Funding Requirements Under Current Policies (Baseline)	127	109	9	180	301	384	1,110
Extended Collections of Fees at 0.5 Percent	90 a/	111	126	143	159	171	800
Extended Collections of Fees at 1 Percent	180 a/	222	252	286	318	342	1,600
Collections of Fees Under S.2391	90 b/	222	0	0	0	0	312

a. Full-year impact.

b. A total of $135 million in fees would be expected in 1984 under S.2391, but only the $90 million collected after April 1, 1984 would be credited to the Fund.

fee collections would fall below the annual fund deficits, and excess collections from prior years would have to be used to make up the difference. CBO projects that the operating deficits under current policies will be so large after 1990 that appropriations will be required in addition to the higher fees. Only if the permanent 1 percent origination fee is credited to the fund, in combination with improvements in the operating efficiency of the program, could this approach be expected to maintain the fund's solvency permanently. A drawback in any scheme involving automatic financing by origination fees, however, is a potential loss of Congressional control.

Appropriations

A measure of Congressional control could be restored by resorting to financing the Guaranty Fund's deficits through the annual appropriations process. Indeed, if the monies needed were appropriated to the VA's Readjustment Benefit Account and then transferred to the Guaranty Fund, no change in authorizing legislation would be needed.

Mr. Chairman, this concludes my remarks. I will be happy to respond to any questions the Committee may have.

Statement of

ROBERT J. MAHN
SENIOR VICE PRESIDENT - MORTGAGE OPERATIONS
FEDERAL NATIONAL MORTGAGE ASSOCIATION

Before the

COMMITTEE ON VETERANS' AFFAIRS
HOUSE OF REPRESENTATIVES

MARCH 15, 1984

Mr. Chairman and Members of the Committee:

My name is Bob Mahn. I am Senior Vice President - Mortgage Operations for the Federal National Mortgage Association.

The Federal National Mortgage Association -- also known as Fannie Mae -- began in 1938 as a subsidiary of the Reconstruction Finance Corporation, chartered by the Federal Housing Administrator. After several reorganizations, the Congress in 1968 separated Fannie Mae into two distinct organizations: Fannie Mae and the Government National Mortgage Association (Ginnie Mae). Fannie Mae became a privately owned corporation, listed on the New York and other Stock Exchanges and supervised in certain respects by the Secretaries of Housing and Urban Development, and Treasury. It has a 15 person Board of Directors. Ten are elected by the 33,000 holders of its 65 million shares of stock; the remaining five are appointed by the President of the United States.

Fannie Mae was chartered by the Congress to help finance housing. It purchases mortgages from financial institutions, such as mortgage bankers, savings and loan associations, and commercial and savings banks, thus restoring their liquidity. Fannie Mae obtains funds to purchase these mortgages largely through short- and medium-term borrowings in the capital markets.

33-959 O—84——5

Fannie Mae's secondary market activities improve the efficiency of the housing finance market. Its operations transform mortgages from small, illiquid, and local investments into highly rated securities which attract money to housing. The national scope of Fannie Mae's operations has helped balance the flow of mortgage funds among geographic regions of the nation. Fannie Mae has also worked with Ginnie Mae and HUD to increase the availability of low- and moderate-income housing.

Fannie Mae owns about 450,000 VA loans -- some $11.2 billion, representing 11 percent of all VA home mortgages outstanding. These loans are secured by properties located in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands and Guam. A full state distribution of our VA portfolio appears at the end of this paper.

I appreciate having the opportunity today to discuss the Administration's stated budget policy for FY 1985 to change VA's practice of paying the full foreclosure claim amount and accepting title to the acquired property in most instances. In his Budget Message (page 5-140) the President stated that, beginning in mid-1984, the VA will uniformly pay guaranty claims in lieu of purchasing properties at foreclosure sales.

Because of the size of Fannie Mae's VA portfolio, this matter is of vital interest to us. We are particularly concerned about the retroactive effect of this change in policy. Our purchasing decisions and pricing determinations for such mortgages have been based on the knowledge and understanding that we could rely on VA's guaranty and also on its practice of accepting title to the majority of the properties acquired through foreclosure. We have relied on VA's appraisals and credit underwriting of new loans rather than duplicating the effort by undertaking these tasks ourselves. The fees we charge and the prices we pay today for VA mortgages reflect these practices and understandings.

Implementation of the Administration's plan that VA pay the guaranty amount in almost all cases would be a most unfair and disruptive change. It will mean that all of our past VA loan purchases were based on invalid assumptions. Such action will require that we consider steps to protect Fannie Mae against losses that were not expected at the time these loans were purchased. One such measure would be to charge higher fees and/or discount points for all future VA mortgages purchased, sufficient to cover unanticipated losses on existing loans as well as on those that may be purchased in the future. This could mean that many future applicants for VA loans would be faced with higher housing costs because these veterans would be required to absorb an additional financial burden to offset anticipated losses for their own loans as well as for all VA loans now in our portfolio.

Although the exact losses that we would incur as a result of the planned change depend on a number of circumstances, we can estimate the potential impact based on our past experience. For instance, in 95 percent of our recent foreclosures, VA paid the full claim amount and acquired the property. A change in VA policy could mean that we could be faced with managing and marketing the properties for 100 percent of our foreclosures, instead of the 5 percent for which we are now responsible. Using our 1983 experience, we estimate that, over the next three years, we would acquire an additional 7800 properties as a result of this change. This would result in a significant increase in the size of our property management staff and the associated administrative expenses. Our best estimates indicate that we would have to sell properties for an average of at least 56 percent of their original value to avoid a loss. In many parts of the country, high incidences of vandalism, long redemption periods, stagnant real estate markets and declining property values make that goal difficult to attain.

The Administration's position is based on the estimate of the President's Private Sector Survey on Cost Control (Grace Commission) that this change would affect 10,150 cases in the first year, saving VA $68 million. That $68 million savings to VA represents a loss for the holders of the mortgages. Since Fannie Mae holds 11 percent of the outstanding VA loans, we can conclude that about $7.5 million of that will be transferred to us. However, our own estimates, based on actual 1983 foreclosure experience--

for both Fannie Mae and the VA itself -- indicate that the change would more likely affect 20,000 cases. Using those estimates, our losses could be $15 million the first year.

Whether our losses would be the $7.5 million developed from the Grace Commission's estimates, our estimate of $15 million, or some other number, such continuing losses would require that we find ways to offset these new risks. We have several alternatives available. Unfortunately, all of them, either directly or indirectly, would very likely increase the cost of housing and decrease the mortgage financing available to veterans.

The obvious solution for avoiding additional risks on VA loans is to stop buying VA loans altogether. Fannie Mae does not intend to do that. In fact, we believe that the planned change may create a greater need for Fannie Mae to be a purchaser of VA loans. At present, the majority of VA loans are pooled to create Ginnie Mae mortgage-backed security issues since Ginnie Mae's guaranty is backed by the full faith and credit of the federal government and lenders can get a better price for their mortgages by pooling them. Because the lender must absorb all foreclosure losses for loans placed in Ginnie Mae pools, lenders will be reluctant to pool VA loans if the plan goes into effect. Without the Ginnie Mae mortgage-backed security outlet, the cost of VA mortgage financing will be higher and some veterans with qualifying income today will be cut off from mortgage funds in the future.

As we see it, there are four basic alternatives that Fannie Mae must consider to minimize our potential losses if this change becomes effective. These alternatives can be considered separately or in some combination.

1. Fannie Mae could require a minimum 5 percent downpayment on all VA loans it purchases.

   At present, we will purchase a VA loan up to $110,000 without requiring a downpayment. One of the factors that makes a VA loan attractive is its "no downpayment" feature. If we require a minimum downpayment -- 5 percent is also our requirement for conventional loans -- we can reduce the probability of foreclosure and the risk of loss in the event of foreclosure. Both outside studies and our own experience support that premise. This change in policy would make it impossible for some veterans to purchase a home.

2. Fannie Mae could decrease its maximum exposure on VA loans from 75 percent to 70 percent.

   We currently buy VA loans up to four times the VA guaranty amount, plus any downpayment made by the veteran, subject to a maximum loan amount of $135,000. Our maximum loss exposure is therefore 75 percent of the loan amount. We follow this same approach for conventional loans by requiring any exposure in excess of 75 percent to be covered by private mortgage insurance.

By reducing our maximum VA exposure to 70 percent, we would be recognizing the additional risk that will be created if the change in VA's policy occurs. The reduced exposure would reduce our risk of loss. This change could impact a greater number of veterans than would be affected by the first alternative. First, veterans wanting "no downpayment" loans would be limited to a $91,500 loan rather than the current $110,000. In addition, although we would still buy loans up to $135,000 with a downpayment, the amount of the required downpayment would be larger.

3. Fannie Mae could require a separate appraisal and an analysis of the veteran's ability to pay, based on our standards for conventional loans.

Lenders now evaluate an application for a VA loan based on VA's credit underwriting standards. VA designates its own appraisers to establish a reasonable value for the property. Fannie Mae purchases VA loans solely on the basis of their having met VA's underwriting and property standards. A change to our policy would require lenders to base their underwriting decisions on our conventional underwriting standards, which tend to be more strict than VA's. We would also require a separate appraisal to assure that the property's value adequately supports the proposed loan amount.

Stricter credit underwriting standards should result in a lower foreclosure ratio, while requiring a separate appraisal should result in fewer foreclosure losses by eliminating questionable properties. The impact of this alternative to veterans is twofold. First, the cost of VA financing would increase by the cost of the required appraisal -- between $125 and $200. Because VA will not allow the veteran purchaser to pay this cost, it will be passed on to the property seller. Property sellers tend to increase the property's sales price to cover such costs or avoid accepting an offer for VA financing when it entails additional expenses. The application of stricter credit and property standards can reduce the number of veterans who are able to get new loans.

4. Fannie Mae could increase its required yield to compensate for additional anticipated losses on VA loans.

Since the purpose of a required yield is to reflect the risk inherent in the mortgage, the introduction of increased risks for VA mortgages would logically lead to higher yield requirements. The degree of any increase would have to take into consideration a number of factors -- our increased administrative expenses, the time that acquired properties would have to be held as non-earning assets, our borrowing

costs, etc. Any increase in our yield requirements would add to the cost of VA financing since lenders would charge additional discount points at origination to offset the lower price they would be receiving for the loan in the secondary market. At current interest rates, a one-quarter of one percent increase in yield represents between one and one and a half discount points in price.

We at Fannie Mae can appreciate efforts toward cutting government costs and we recognize that no single recommendation can be acceptable to everyone when it affects such a wide diversity of interested parties. We face that same dilemma in reaching a decision on the action we will take if the plan is implemented. However, we feel that it is particularly unfortunate and unavoidable that under each alternative the nation's veterans will bear the burden and will suffer the loss of benefits presently available by federal law.

Figures obtained from the Veterans Administration regarding 8818 properties sold during the first seven months of FY 1983 indicate that the total loss per case averaged $14,400, including guaranty payments and all property management, selling and carrying costs. The average guaranty amount for these properties was approximately $19,000. By acquiring and disposing of the properties,

the VA saved $4,600 per case, or a total of over $40 million. In view of the fact that the Administration's planned policy change may cost the VA money, surely it should be subjected to further consideration and study by the Congress.

The current VA policy has functioned effectively over the years. It places no undue financial burden on either the veteran, the mortgage lender or the government. The planned change would be costly for veterans, mortgage lenders and, quite possibly, the federal government. We question whether the change will provide the anticipated reduction in federal government expenditures.

The short run method to replenish the Loan Guaranty Revolving Fund is to aggressively dispose of the current inventory of 25,000 properties. Using VA's 1983 averages for sales price and related expenses, we estimate that this inventory has a net realizable value of $750 million. Even if sold for a lesser amount, the proceeds would significantly restore the Loan Guaranty Revolving Fund. In the longer term, with prudent underwriting, property management and marketing practices and realistic bidding on foreclosed properties, the cost of this program could be significantly reduced. The answer does not lie, either in the short run or the long run, in adopting a policy of uniformly paying the guaranty amount in virtually all cases.

Although the Administrator of Veterans Affairs has the authority to implement this new policy without statutory change, the significance of the planned change warrants Congressional action. In our opinion, a change of such potential importance to the entire VA housing program should not be adopted by the Administrator without Congressional sanction. We strongly urge that the VA's present policy be retained -- it works, without unfairly penalizing any one sector or adding to the cost of housing for America's veterans.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
VA PORTFOLIO
STATE DISTRIBUTION

REGION	LOAN COUNT	PRINCIPAL BALANCE (IN 000'S)
Southeastern	101,449	$2,376,377
AL	14,220	343,618
FL	25,149	692,600
GA	18,725	452,590
KY	3,873	68,644
MS	4,164	92,107
NC	14,354	294,978
SC	8,403	179,340
TN	12,561	252,499
Midwestern	72,327	$1,426,191
IL	11,477	255,517
IN	14,620	239,430
IA	2,481	55,389
MI	14,058	251,523
MN	6,101	173,940
NE	1,196	28,399
ND	32	1,104
OH	19,763	356,859
SD	258	7,088
WI	2,341	56,942
Southwestern	110,016	$2,455,102
AR	3,794	71,290
CO	13,561	365,815
KS	5,640	105,409
LA	15,081	378,661
MO	7,192	126,918
NM	4,188	69,110
OK	9,732	203,335
TX	50,828	1,134,565
Western	110,626	$3,318,028
AZ	13,030	359,376
CA	69,711	2,102,827
ID	2,213	64,253
MT	724	18,915
NV	6,047	186,688
OR	946	21,525

REGION	LOAN COUNT	PRINCIPAL BALANCE (IN 000'S)
Western (cont...)		
UT	4,817	132,211
WA	9,629	295,387
WY	1,648	54,344
AK	572	22,522
HI	1,045	49,562
GU	244	10,417
Northeastern	59,153	$1,558,033
CT	276	9,191
DE	939	24,008
DC	1,674	41,573
ME	51	1,867
MD	7,841	265,848
MA	290	10,166
NH	64	3,325
NJ	10,144	259,806
NY	7,156	177,441
PA	10,588	207,008
RI	8	339
VT	1	56
VA	16,887	500,356
WV	345	6,832
PR	2,830	48,728
VI	59	1,487
National:	453,571	$11,133,731

1125 Fifteenth Street, N.W.
Washington, D.C. 20005
202-861-6500

Mortgage Bankers Association of America

STATEMENT OF

RONNIE J. WYNN

PRESIDENT
COLONIAL MORTGAGE COMPANY
MONTGOMERY, ALABAMA

on behalf
of the

MORTGAGE BANKERS ASSOCIATION OF AMERICA

before the

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS

of the

COMMITTEE ON VETERANS' AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

Oversight Hearing on

The Veterans Administration Home Loan Guaranty Program

March 15, 1984

Mr. Chairman and Members of the Subcommittee, my name is Ronnie J. Wynn. I am President of Colonial Mortgage Company of Montgomery, Alabama, a mortgage banking company, and a member of the Executive Committee of the Mortgage Bankers Association of America.* Accompanying me are Burton C. Wood, MBA's Legislative Counsel, and William E. Cumberland, MBA's General Counsel.

Before beginning our testimony, Mr. Chairman, we want to thank you for moving so promptly upon learning of the proposal of the Veterans Administration (VA) to change its procedure for satisfying guaranties under the VA home loan guaranty program. Your quick and strong objection that the change should not be implemented without Congressional review has given the VA an opportunity to avoid making a serious mistake.

We appreciate the opportunity to appear before you today to testify on the Administration's proposal to discontinue acquiring properties after default; on HR 4685, a bill to increase the guaranty limits in the program; and on the VA home loan guaranty program generally.

---

*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership comprises mortgage originators, mortgage investors, and a variety of industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include:

- o Mortgage Banking Companies
- o Mortgage Insurance Companies
- o Life Insurance Companies
- o Commercial Banks
- o Mutual Savings Banks
- o Savings and Loan Associations
- o Mortgage Brokers
- o Title Companies
- o State Housing Agencies
- o Investment Bankers
- o Real Estate Investment Trusts

MBA headquarters is located at 1125 15th Street, N.W., Washington, D.C. 20005; telephone: (202) 861-6500

MBA believes that the home loan guaranty program is an excellent one and that the VA has operated the program well. We oppose the change in the manner in which the program has been operated, as proposed in the President's Budget for FY 1985. We also oppose the proposal in the President's budget that the VA discontinue selling vendee loans with recourse. We support the proposal in HR 4685 to increase the maximum guaranty to $30,000 from $27,500. We urge that the guaranty fee imposed on veteran borrowers be allocated to the VA rather than reverting to general Treasury funds. MBA also urges that the maximum interest rates on VA loans not be administratively set and that the VA be authorized to guarantee mortgages with adjustable interest rates.

VA HOME LOAN GUARANTY PROGRAM

Included in the President's Budget for FY 1985, submitted to Congress on February 1, 1984, is a statement that the VA will make substantive changes in the way that the VA home loan guaranty program operates. The budget says that, "Effective March 1st, 1984, VA will pay the lender's claim in accordance with the terms of the guarantee." This policy would change the current practice of acquiring title and disposing of the foreclosed property, a practice that is more cost effective for the taxpayers; is consistent with FHA procedure; has encouraged active lender participation in the VA guaranty program since 1944; and has enabled lenders and investors to make home financing available to veterans on better terms than are available in the conventional market.

Although the Administration by a letter dated February 22, 1984 and addressed to Committee on Veterans' Affairs Chairman G. V. Montgomery and other Congressional leaders, has indicated that implementation of the proposed change will be deferred until October 1, 1984, and that the proposal will be studied further, there has been no

indication that the Administration has abandoned its intent to implement the change. MBA, therefore, wishes to comment on the proposed change.

The change is aimed at the VA's role in the event of a foreclosure. When a VA-guaranteed loan falls into default, the VA has two paths of action open to it. It can pay the lender the guaranty amount, which is 60 percent of the loan amount up to a maximum of $27,500, or it can pay the costs the lender has incurred and take title to the property. Based on its analysis of the cost to the government, the VA has opted for the latter course of action, acquisition of the property, in more than 95 percent of guaranty claim cases over the life of the program. After taking title to the property, the VA performs necessary maintenance and renovation work and then sells the property, recouping all or part of its expenditures.

In accordance with the President's budget proposal, the VA would cease to acquire properties and would simply pay the guaranty in all cases. This policy had its origins in work done by a task force of the President's Private Sector Survey on Cost Control, better known as the Grace Commission after its chairman, Peter Grace. There are inconsistencies and oversights in the Commission's analysis, which will be discussed later in the testimony. Not the least of these is the lack of understanding of the impact this proposed change in policy would have on the market for VA-guaranteed loans and ultimately on veterans themselves.

Operation of the VA Home Loan Guaranty Program

The VA home loan guaranty program is an entitlement program established under the Serviceman's Readjustment Act of 1944. The program provides two primary benefits to qualified veterans. First, the VA guarantees a portion of the veteran's mortgage

principal. The amount of this guaranty has varied over the years and is now 60 percent of the loan amount, up to a maximum of $27,500. The second benefit offered by the program is the stipulation that no downpayment need be required by the lender. A loan with no down payment is a "100 percent loan" because the loan amount is 100 percent of the value of the property. On a monthly basis from 1981 to 1983, between 52 percent and 71 percent of VA-guaranteed loans closed were 100 percent loans (Exhibit 1).

VA-guaranteed loans made up almost 8 percent of all single family mortgage loans originated in 1982 (Exhibit 2) and 10 percent during the first three quarters of 1983.

Since the VA initiated its program in 1944 until the end of September 1983, 11.5 million loans have been guaranteed. The vast majority of those loans have cost taxpayers only the minor administrative cost of processing the initial approval. Only 4 percent of those loans have resulted in foreclosure. The foreclosure rate for VA-guaranteed loans has increased somewhat in the past two years following the severe recession that gripped the U.S. economy and the historically high unemployment rates that resulted (Exhibit 3).

The budgetary mechanism for the VA home loan guaranty program is the Loan Guaranty Revolving Fund (LGRF). The fund was established to balance the income and expenses caused by the operation of the program. The source of income for the fund is primarily from the sale of "vendee" loans. Vendee loans are made by the VA to a borrower (veteran or non-veteran) when an acquired property is sold to that borrower by the VA. By reselling its acquired properties, the VA recoups some, if not all, of the costs incurred to acquire the property. The vendee loans are then sold to investors. Expenses accrued by the LGRF are predominantly from the acquisition and sale of foreclosed properties.

When the LGRF is in a deficit position, the VA transfers money from its Direct Loan Revolving Fund (DLRF). The DLRF exists as a result of a former VA policy to make loans to veterans who live in credit-short areas and can find no other lender to make a VA-guaranteed loan. In this instance, the VA acts as a lender and has accumulated a surplus in the DLRF.

Recently, the VA was instructed by the Administration to sell the loans the VA holds as a result of its activities as a direct lender and to make no more direct loans. Consequently, the asset base of the DLRF is disappearing. In addition, due to the sophistication of the mortgage markets, there are currently few credit-deficient areas in the country and, therefore, there is less demand for direct loans. Thus, at a time when the LGRF is experiencing great cash demands due to the recent recession and ensuing increased foreclosures, the DLRF is in its most illiquid position.

The LGRF expects to lose at least $100 million in FY 1984, according to a Congressional Budget Office estimate. It is this expected deficit that caused the Reagan Administration to propose that the VA no longer acquire properties.

Erroneous Assumptions of the Administration's Analysis

The Grace Commission task force rested its recommendation on two major points, and apparently the Administration does as well. First, there is an assumption that, if the VA ceases to acquire foreclosed properties, there will be an enormous apparent cost saving to the government. Second, the task force compared the VA's experience with foreclosed properties with methods used by the private mortgage insurance industry. There are flaws in both these assumptions.

The VA will not save money by paying the lender the guaranty amount in a default case. When the past experience of the VA is examined, it is clear that, since 1979, the average loss on properties acquired and subsequently sold is about $10,000 less than if the VA had paid the average guaranty on those properties (Exhibit 4). The proposed change would cause a greater drain on VA finances than the current policy because VA's cash inflow will be diminished once the current inventory of properties is liquidated.

In comparing the VA methodology with that of private mortgage insurance companies, the Commission overlooks a crucial variable—risk exposure. The mortgage insurance companies guarantee only 20 to 25 percent of the loan amount. Consequently, for loans with similar balances outstanding, their liability is far less in the case of a foreclosure than the VA's, which guarantees 60 percent of the loan amount up to $27,500.

If a $50,000 loan goes into foreclosure, it is advantageous for a mortgage insurance company with a 20 percent exposure to pay the claim on the property if the anticipated loss on the acquisition and resale of the property were as low as $10,001. The VA, on the other hand, should pay the guaranty only if the anticipated loss is greater than $27,500.

The far greater exposure of VA makes it inappropriate to compare the practices of the two institutions in setting losses. The higher exposure of the VA compared with private mortgage insurance company coverage indicates that it often will be in the taxpayers' best interests for the VA to acquire property, even though mortgage insurance company coverage on the same property would lead to a payment of the claim.

Effect on Lenders and Veterans

The change in the VA guaranty settlement policy suggested by the Administration would affect most directly both VA lenders and veterans themselves.

As a group, mortgage bankers make about three-quarters of all VA-guaranteed loans, more than any other class of lenders (Exhibit 5). Thus, mortgage bankers would be affected more than other lenders by the change in VA policy. The impact will affect certain aspects of a lender's business, as well as the lender's perception of the risk potential of a VA-guaranteed loan.

One of the major assumptions made by the task force of the Grace Commission is that, if the VA does not acquire a property by entering a bid to do so, there will be a third party who will acquire the property from the lender. By making this assumption, the Administration sidesteps the issue of a lender being left holding title to property. The assumption that a third party buyer would come forward assumes a perfect market. There may be a prospective buyer in the market for the foreclosed property at a price near or below what the VA would have bid. The problem is that foreclosure sales require ready cash and information not available to most buyers.

A more realistic scenario is that, if the VA enters no bid, in only a small percentage of cases will a third party take title to the property. The majority of foreclosures will result in the lender taking title to the property and being responsible for maintenance, renovation, marketing, and eventual sale of the property.

The vast majority of lenders, especially small mortgage bankers, are not capitalized to deal with property disposition. In order to complete the transfer quickly and efficiently,

lenders would be forced either to develop property disposition centers or turn to others who, for a fee, would handle the property disposition. Either approach would put lenders, especially the smaller ones, under great financial strain. Needless to say, it would also make VA-guaranteed loans less attractive to lenders and increase the cost of mortgage credit to veteran borrowers. Vietnam-era veterans, who are still entering the housing market as first-time homebuyers, would perhaps be particularly hard hit by this proposed change.

VA-guaranteed loans would be perceived as carrying a much larger share of risk to lenders in the mortgage markets. Lenders would begin to apply more stringent underwriting procedures to applications of prospective VA borrowers and might even cease to offer VA-guaranteed loans in small towns, rural areas, and economically depressed areas where a foreclosed property might be especially difficult to sell. A higher yield would be required in the market to compensate investors for the additional risk they are accepting by purchasing a VA-guaranteed loan.

By making this policy change, the Reagan Administration would be creating an atmosphere in which veterans with VA-guaranteed loans will be second class citizens. This seems directly opposed to the concept that legislators had for the program at its inception in 1944.

Retroactivity

The proposal in the President's budget would apply to all loans guaranteed by the VA, even those loans made by lenders over past years. When the loans now held in portfolio were made, the VA had led lenders to believe that the VA home loan guaranty program would be operated in a manner that would not require lenders to establish and maintain property

disposition departments, or otherwise absorb the costs of property disposition. Lenders made and priced their loans relying on the VA to protect the lenders from losses in the event veteran borrowers defaulted. To change the rules for loans already made would obviously be unfair to lenders, but it would also tend to discourage future participation in the veterans' loan program, because lenders, once burned, would be naturally and understandably reluctant to continue participating in the program.

Protection of the Veteran in Temporary Difficulty

There is a concerted effort on the part of lenders and the VA to protect the veteran who is in temporary difficulty by allowing him or her to continue to occupy the house as long as possible, even after delinquency in mortgage payments occurs. When the VA acquires title to the home after default, it does not require lenders to evict the veteran and, in many instances, allows the veteran to continue to occupy the home, making rental payments to the VA. If lenders or third parties are forced to acquire properties upon default, this appropriate social concern for the veteran cannot be exercised or controlled by the VA.

This is not to suggest that lenders will cease working with borrowers to avoid foreclosure where reasonably possible, as we describe later in the testimony. But once the business judgment is made that foreclosure is called for, eviction of the veteran will, of necessity, be swift in most cases.

VENDEE LOANS

The President's budget for FY 1985 indicates that the VA will discontinue selling vendee loans with recourse. MBA is opposed to this proposed change in current practice. Sale of vendee loans without recourse will shift the credit risk of default from the VA to private purchasers, and purchasers will adjust their purchase prices accordingly. Because of its size, and because it is the lender, the Government is a more efficient manager of vendee loan credit risk than any private buyer can be. Therefore, it is highly likely that the reduction in the sales price paid by the private industry buyers of vendee loans will be greater than the savings the Government will realize by transferring the risk of default.

INCREASE IN GUARANTY MAXIMUM

MBA supports the proposal included in HR 4685, introduced by Representatives Shelby, Montgomery, and Hammerschmidt, to increase the maximum amount of the VA loan guaranty from $27,500 to $30,000 for home loans. Such an increase would bring the relationship between the level of the guaranty amount and the ever increasing cost of new and existing housing closer to historical ratios.

From 1974 to 1983, the median price of new single-family homes sold jumped from $35,900 to $75,100, an increase of 109 percent. Had the VA maximum guaranty been adjusted annually in equal proportion to the increase in new home prices, the 1983 guaranty would have reached $36,600 (Exhibit 6 and Exhibit 7).

The median price of existing single-family homes sold increased 120 percent during the period 1974 through 1983, from $32,000 in 1974 to $70,300 in 1983. Adjusting the VA

maximum guaranty for annual increases in existing home prices for this period would have resulted in a maximum guaranty of over $38,000 in 1983 (Exhibit 6 and Exhibit 7).

Increasing the maximum guaranty also will increase the opportunity for VA-backed mortgages to be sold in the highly efficient Government National Mortgage Association (GNMA) mortgage-backed security program. By using this program, mortgage lenders generally are able to provide veterans purchasing homes with financing at a lower rate than is available when the program cannot be used. Under GNMA's practice, only loans with at least 25 percent VA guaranty are allowed in the GNMA program. Increasing the loan guaranty maximum to $30,000 from $27,500 would increase the effective ceiling for GNMA program participation from $110,000 to $120,000 for VA loans.

VA HOME LOAN GUARANTY FUND

MBA applauds the action taken by the House Committee on Veterans' Affairs on March 8, when the decision was made to recommend that $108 million be restored to the FY 1985 budget to assist in funding the VA home loan guaranty program. This step was necessary because the President's FY 85 Budget was based upon the assumption that the VA would discontinue acquiring properties after default. Now that the Administration has indicated that this proposed change in policy is being subjected to further study, wise budgeting practice calls for provisions for expenditures based on a continuation of existing VA policies. As the Committee report on the budget recommendation recognizes, information furnished in the future by the VA may suggest that an adjustment should be made in the amount provided in the budget, but at least the CBO base-line figure of $108 million, derived from current knowledge, should be inserted in the budget now.

The action of the Committee is applauded because MBA understands that the Loan Guaranty Revolving Fund will not be able to support the guaranty activities of the VA during 1984 and 1985 without appropriations. While the VA has not needed appropriations for home loan guaranty activity during the past few years, the economic cycle and certain changes in other VA operations will not allow the VA to provide adequate funding internally this year and next. MBA urges the Subcommittee to take whatever additional steps as may be necessary to provide a sufficient level of expenditure to maintain the functioning of the home loan guaranty program.

In considering requests for authorization and appropriation of funds to support the VA home loan guaranty program, Congress should keep in mind that this program to help veterans obtain housing was not designed nor intended to be actuarially sound or user-fee supported. From the beginning, there was a recognition that the program would need appropriations, and appropriations have been made in several years during the operation of the program.

In 1982, MBA urged Congress to reject the Administration's proposal to impose a one-half percentage point fee for VA-guaranteed loans. We believed that it was inappropriate and could impose an additional burden upon veterans who wish to become homeowners. In calendar year 1982, approximately 58 percent of all VA-guaranteed home loans were no-downpayment loans. This unique feature of the VA loan guaranty program enabled many veterans, who otherwise might not have been able to afford homeownership, to purchase homes of their own.

The funding fee, in some instances, can be the critical expense charge that places homeownership beyond reach. Given the fact that the VA loan program is an entitlement

granted to veterans for past service in the armed forces, MBA believes it is inappropriate to charge a fee to the beneficiaries of the program.

However, Congress permitted a one half percent fee to be charged, and provided that the fee be remitted to the Treasury as general revenue rather than targeted for use by the VA in the administration of the loan guaranty program. Through FY 1983, veterans have paid $77.5 million in funding fees. MBA feels that, because these fees are imposed on veterans using the program, they should be used for program purposes. These fees should be applied directly to defray expenses attached to program administration, similar to the treatment of user-fees under the non-subsidized FHA mortgage insurance programs, rather than treated as general revenues of the Treasury. MBA strongly supports such a change in the use of the funding fee.

On March 7, the Senate Committee on Veterans' Affairs, while refusing to recommend that the FY 85 budget be amended to restore necessary funds as was done in the House, voted to report out a bill, S 2391, which would increase the funding fee from one-half percent to one percent, and would direct the full fund to the Loan Guaranty Revolving Fund. While MBA believes the the appropriate way to assure the continued effectiveness of the VA home loan guaranty fund is to provide such appropriations as are needed, the Senate Committee's approach is acceptable if a disruption of the program is the alternative.

FREE VA INTEREST RATE

Under current law, the maximum interest rate allowable on a mortgage guaranteed by the VA is fixed by the VA Administrator. MBA urges that the law be amended to allow interest rates to be determined by the market.

The setting of a maximum interest rate by the VA Administrator harkens back to an earlier era in America's financial history when residential mortgage markets were highly localized and sometimes dominated by a few suppliers of mortgage credit. The possibility for abuse existed, and the Federal government, in the FHA and VA mortgage insurance and guaranty programs, acted in a fashion similar to state governments and set maximum interest rate ceilings. Federal and state interest/usury ceilings were not a problem as long as interest rate changes occurred infrequently, and in small increments. However, the volatility of interest rates in the latter part of the 1970s and early 1980s turned this restrictive system of interest rate limitations into a hangman's noose around the neck of the housing and mortgage finance industries.

The market forces of supply and demand, together with the national linkage of all local mortgage markets, ensure that no single lender or group of lenders in any locality or region can demand and receive mortgage interest rates above the market rate.

Congress recognized this and preempted state mortgage usury ceilings in the Depository Institutions Deregulation and Monetary Control Act of 1980. Then, after seeing how the market reacted to the lifting of usury ceilings, last year Congress removed the requirement that FHA-insured mortgages be subject to administered interest rates.

In enacting Section 404 of the "Housing and Urban-Rural Recovery Act of 1983," Congress freed the FHA program to compete with the conventional market in tailoring interest rate and discount point combinations to fit the needs of individual borrowers. Early observations of the impact of the freely negotiated rate indicate that the market impact has been favorable, but the experience since the November 30, 1983 effective date has not been adequate to quantify the benefits.

Now that Congress has freed the FHA rate, it should free the VA rate as well. All the reasons and factors that justified freeing the FHA rate apply as well to freeing the VA rate. The fact that the VA program remains as the only portion of the market with an administratively set maximum interest rate provides an additional reason for removing administered interest ceilings from the VA program.

If, as history would indicate likely, the VA does not keep the maximum interest rate at or above the current market rate, the market will require builders and other sellers to pay substantial discounts to provide market yield. This condition formerly was true with both the FHA and the VA portion of the market, and builders and other sellers were willing to set prices somewhat higher, or to forgo some profit, in order to fund the financing costs represented by discount points. In the first three quarters of 1983, VA-guaranteed lending constituted approximately 9 percent of the market for existing housing and 11 percent of the new home purchase market. It would seem unlikely that builders and other sellers will continue to risk sales by setting their prices high enough to include the payment of financing costs only for VA program buyers, or be willing to absorb a profit loss when the financing chosen by most potential buyers does not require it.

ADJUSTABLE RATE MORTGAGE

During the past year, adjustable rate mortgages (ARMs) have become accepted by borrowers in the conventional mortgage market. FHA is expected to expand its insurance program to include ARMs within the next few months. MBA urges that the VA be authorized to include ARMs in the home loan guaranty program.

Whatever may have been the case previously, ARMs are no longer an untested and unknown quantity. Approximately 53 percent of new conventional mortgages originated in the last quarter of 1983 were ARMs. With better borrower understanding and limits, or caps, on payment increases defined in the mortgage, ARMs have proven an effective instrument for providing homeownership to individuals whose current economic situation would not otherwise provide it.

MBA appreciates the opportunity to appear before the Subcommittee today and would be happy to furnish any additional information, if needed.

1125 Fifteenth Street, N.W.
Washington, D.C. 20005

Mortgage Bankers Association of America

Burton C. Wood
Senior Staff Vice President and Legislative Counsel

202-861-6507

March 16, 1984

The Honorable Richard C. Shelby
Chairman
Subcommittee on Housing and
Memorial Affairs
Committee on Veterans' Affairs
U. S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

During hearings on the Veterans Administration home loan guaranty program, which you conducted on March 15, 1984, you requested that MBA submit, for the record, the correspondence MBA had with The White House and with the President's Private Sector Survey on Cost Control. In response to that request, we enclose copies of the following letters:

From Glen S. Corso to J. Peter Grace
dated May 16, 1983,

From Dr. Mark J. Riedy to J. Peter Grace
dated December 8, 1983,

From Felix M. Beck to Craig L. Fuller
dated January 11, 1984,

From Craig L. Fuller to Felix M. Beck
dated February 27, 1984.

Although the letter from Craig L. Fuller to Felix M. Beck is dated February 27, MBA received it on March 9.

We appreciate this opportunity to contribute to the work of the Subcommittee, and we would be happy to furnish additional information, if needed.

Sincerely,

Burton C. Wood

Enc.
BCW:amk

1125 Fifteenth Street, N.W.
Washington, D.C. 20005

Mortgage Bankers Association of America

Glen S. Corso
Staff Vice President
Government Agency Relations
(202) 861-6534

May 16, 1983

Mr. J. Peter Grace
Chairman
President's Private Sector Survey on
Cost Control
1850 K Street, N.W.
Suite 1150
Washington, D. C. 20006

Dear Mr. Grace:

The Mortgage Bankers Association of America (MBA) would like to take this opportunity to comment on the President's Private Sector Survey on Cost Control's Task Force Report on the Veterans Administration (VA). We will restrict our comments to the section of the report dealing with foreclosure options. This section of the report suggests that the VA should not continue to acquire title to properties financed through its guaranteed loan program that are terminated through foreclosure.

The object of the VA Home Loan Guaranty Program is to facilitate the extension of mortgage credit on favorable terms by private lenders to eligible veterans for the purchase, construction repair, or refinancing of homes to be occupied by veterans. Since the inception of the program, VA has extended more than $204 billion to veterans for home purchases. Over 11 million mortgage loans have been made under the program. In 1982, nearly 82 percent of all VA guaranteed home loans were originated by mortgage bankers.

Unlike any other mortgage program, either Federally-insured or conventional, the VA home loan program allows eligible borrowers to receive up to a 100 percent (no down payment) mortgage. Lenders are willing to operate under the program because of the VA loan guaranty. A VA loan guaranty is actually a partial guaranty against loss. Currently, the maximum VA guaranty is the lesser of $27,000 or 60 percent of the loan amount. The lender remains liable for the excess of the loss over the guaranteed amount. In the event of default, VA has the option to pay the holder of the loan the guaranteed portion of the loan or provide a bid price and accept title to the property at that bid price. As the Task Force Report points out, the VA almost always takes the second option and acquires title to the property.

The Report assumes that if the VA did not acquire the property, someone else would at approximately the same price level (Task Force Report, see p. 41). This is a false assumption. The Report itself indicates that less than five percent of VA properties sold at foreclosure sale are acquired by third parties.

Statistics obtained from the VA and submitted to Congress in VA's fiscal year 1984 budget submission show that it would cost the VA much more to pay the guaranty amount than to acquire the property. The Report states (p. 42) that under the current system of acquiring properties, the VA average loss is $6,700 per unit. The VA budget statistics state that in fiscal year 1982, if VA had acquired no foreclosed properties and instead had paid the guaranty claim, losses to VA would have averaged $16,675 per unit. Additionally, this same source reported that for fiscal year 1982, the average loss per property was $4,300, not $6,700 as stated by the Task Force. We would suggest that the Task Force reevaluate these numbers and consider the cost to VA of paying the guaranty amount before making its recommendation.

The Report further states (p. 43) that the Federal National Mortgage Association (FNMA) recently changed its pricing philosophy to discourage lenders from selling them VA loans because FNMA questions the quality of underwriting VA loans used by the industry. The statement in regard to FNMA's policy is incorrect. FNMA's change in policy regarding the purchase of VA loans in no way reflects its attitude about the quality of VA loans. As investors, FNMA was always 100 percent protected by the VA loan guarantee and VA title acquisition policy. FNMA's decision not to purchase VA loans reflects that Association's wish not to purchase any assumable home mortgage loans--it has nothing to do with the quality of VA loans.

The Report is correct when it states (p. 42) that because the indemnification provided by VA's policy of acquiring properties at foreclosure, the lending community is able to offer borrowers more competitive terms under the VA home loan program. A change in this policy would mean less indemnification to lenders and would surely result in less availability of the VA home loan program to veterans.

The Report states (p. 42) that when the VA establishes its bid price for properties it does not include the costs to the VA for acquisition, sales expenses, and property management while the VA holds the property. In January, 1983, the VA changed its policy to include these costs in establishing bid prices.

The last point we would like to address with this section of the Report is the comparison between the operations of the private mortgage insurance (PMI) industry and the VA. The Report ignores the fact that PMIs provide protection for up to 20 to 25 percent of the total claim, while VA's guaranty amount, the lesser of 60 percent of loan amount or $27,000, is much greater. PMI's lesser exposure provides more incentive to pay the claim when a property goes into foreclosure.

33-929 O—84——7

The Task Force also has recommended that the VA schedule portfolio loan sales at regular intervals and that the VA act as an issuer of securities. MBA agrees with this recommendation that would allow the VA sufficient flexibility to take advantage of market conditions in the best interests of the solvency of the VA home guaranty loan program.

We appreciate this opportunity to comment and hope the Task Force will reconsider its recommendation on the VA's policy of acquiring properties at foreclosure sales on guaranteed loans.

Sincerely,

Glen S. Corso

Glen S. Corso
Staff Vice President

GSC/en

1125 Fifteenth Street, N.W.
Washington, D.C. 20005

Mortgage Bankers Association of America

Dr. Mark J. Riedy
Executive Vice President
(202) 861-6501

December 8, 1983

Mr. J. Peter Grace
Chairman
President's Private Sector Survey On
Cost Control
1850 K Street, N.W.
Suite 1150
Washington, D.C. 20006

Dear Mr. Grace:

On May 16, 1983, the Mortgage Bankers Association of America (MBA) submitted written comments to you regarding the President's Private Sector Survey On Cost Control's Task Force draft report on the Veterans Administration. The points that we raised in that letter were not addressed in the final report that went to the President. Therefore, MBA would like another opportunity to explain our opposition to the Task Force's recommendation regarding foreclosure options on VA guaranteed mortgages.

The recommendation in this section of the report is that, as a matter of policy, the VA should not continue to acquire title to foreclosed properties that were financed through the VA Home Loan Guaranty Program. Based on the financial consequences to the government, the Task Force recommendation is unwise because the government will lose more money than it would under the present policy. Additionally, adoption of the Task Force recommendation would have a disastrous effect on the market for VA loans, contrary to the legislative intent of the Act.

Our first point concerns the financial effect on the government. When a VA guaranteed loan is in foreclosure, the VA has the option either to pay the lender the guaranteed portion of the loan (the lesser of 60 percent of the loan amount or $27,500) or to provide a bid price and accept title to the property at that price. These options provide an effective mechanism whereby the VA can minimize its loss on every foreclosed mortgage. A blanket policy for the VA not to acquire property defeats the Task Force's mission. It will not save the tax payers' money.

The Task Force wrongly assumes that if the VA did not acquire properties, someone else would at approximately the same price. Less than 5 percent of all VA guaranteed loans that go to foreclosure sale are acquired by third-parties. Therefore, on the remaining 95 percent, the VA either must acquire the property or pay the lender the guaranteed portion of the loan. If the VA implemented a policy of not acquiring properties, it would be required to pay the lender $27,500 or 60 percent of the loan amount on every foreclosed VA loan. Thus, tremendous outlays of government funds would go to pay lenders the guaranteed portion and the VA would be left without any properties to sell to recover any portion of its losses.

Statistics obtained from the VA and submitted to Congress in VA's fiscal year 1984 budget submission show that in FY 1982 the VA would have lost almost $10,000 more per unit by uniformly paying the guaranty amount, compared with what it lost in acquiring property. The Task Force's report states that under the current system for acquiring properties, the VA's average loss in FY 1982 was $6,700 per unit. The VA budget statistics show that in FY 1982, if the VA had acquired no foreclosed properties and instead had paid the guaranty portion, losses to the VA would have averaged $16,675 per unit. Additionally, this same source reported that for FY 1982, the average loss per property was $4,300 not $6,700 as stated by the Task Force.

The Task force compared the private mortgage insurance (PMI) industry's approach to property acquisition with the VA's approach. The report states that since 1981 the PMI industry has acquired only 10 percent of the foreclosed properties. This comparison completely ignores the fact that the PMI companies provide protection for only 20 to 25 percent of the loan amount, while the VA's guaranty is for 60 percent of the loan amount or $27,500, whichever is less. The lesser exposure of the PMI companies provides a much greater incentive to pay the insured amount, rather than to acquire the property. For example, if a decision is made not to acquire the property on a $48,000 loan, the PMI company would pay the lender $12,000, while the VA would be required to pay the lender $27,500. Therefore, the Task Force's advocacy of the PMI approach to property acquisition is not valid for the VA and would not result in cost savings for the government.

The Task Force's report states "To our knowledge, the VA always has provided a bid price to the lender." It is possible that this was true when the research for the report was conducted. However, just during the first six months of 1983, there were 354 cases in which the VA provided no bid price and did not acquire the property. Additionally, since the research for the report was done, the VA has established a policy for considering in its determination of a bid price the cost associated with repairing, maintaining and marketing acquired properties.

It seems clear that during 1983 the VA adopted a more realistic approach to market analysis and a more stringent fiscal policy for exercising its options on defaulted loans. Better administration of the procedures for disposing of acquired properties could further reduce program budget outlays.

However, it is vital that the administration of the VA Home Loan Guaranty Program not be confused with the mechanics of the program. A flexible system that provides true options for the VA to minimize its losses is much more fiscally responsible than a rigid procedure that will result in a loss to the VA in every case.

Our second point concerns the effect of the Task Force recommendation on the market for VA loans. The lending community is able to offer veterans terms under the VA Home Loan Guaranty Program that are more favorable than any other form of home financing because of the indemnification provided by the VA's policy of acquiring properties at foreclosure. The Task Force recommendation restricting this policy would discourage investors from contributing capital necessary to make VA home loans available to veterans. Administering the program by reducing the availability of VA home loans to qualified veterans is contrary, we believe, to the legislative intent of the Servicemen's Readjustment Act.

The conclusions we draw from our analysis of the Task Force recommendation deserves to be addressed directly, something that the final report did not do. The Task Force recommendation fails to control the government's costs, it guarantees that these costs will rise. At the same time, the recommendation would deny many veterans the home loans the law was enacted to provide. The result is a net loss to the government, to the taxpayer, and to the veteran.

If you have any questions regarding the issue raised in this letter, we would be happy to provide further details.

Sincerely,

Mark J. Riedy

Dr. Mark J. Riedy
Executive Vice President

MJR jmp
CC: Harry N. Walters
Administrator
Veterans Administration

Dorothy Starbuck
Chief Benefits Director
Veterans Administration

Robert O'Toole
Director, Loan Guaranty and Service
Veterans Administration

1125 Fifteenth Street, N.W.
Washington, D.C. 20005

Mortgage Bankers Association of America

Felix M. Beck, CMB
President
(202) 861-6500

January 11, 1984

Mr. Craig Fuller
Assistant to the President for
Cabinet Affairs
The White House
Washington, D. C. 20500

Dear Mr. Fuller:

On behalf of the Mortgage Bankers Association of America, I am writing to you in your capacity as coordinator for the implementation of the recommendations of the President's Private Sector Survey on Cost Control (Grace Commission) to express our opposition to implementation of a recommendation that was made by a Commission Task Force but was not adopted by the Commission, that we believe will change the Veterans Administration's (VA) Home Loan Guaranty Program in a significant and harmful way.

In the draft report of the Commission's VA Task Force, a tentative recommendation was made that the VA Home Loan Guaranty Program change its customary practice of acquiring title to most foreclosed properties securing VA guaranteed loans and, instead, pay the guaranty amount. As the originators of the bulk of all VA guaranteed loans, when we became aware of this tentative recommendation in May, we wrote to the Commission expressing our opposition. We believe that if this change in current practice was made, there would be an increase, rather then a decrease, in costs to the VA, and the change could very well result in a diminished and more costly supply of mortgage credit for veteran borrowers.

The Commission then modified the Task Force recommendation prior to including it in the final Commission report to the President. The final recommendation of the Commission is that VA acquire properties at foreclosure sales only when it is in the best interest of the taxpayers. The report does qualify this recommendation, however, with the statement that property should only be acquired in a true exception situation when justification can be made on a case-by-case basis. We believe that VA is following such a practice currently in foreclosure cases and that the economics in most situations compel the decision by VA to acquire the property for subsequent re-sale as a way of reducing potential losses.

It is our understanding, however, from press reports that the Administration has determined that VA should cease acquiring properties in all or almost all foreclosure situations and simply pay the guaranty amount, as was recommended tentatively by the Commission's VA Task Force.

Cost Increases Rather Than Savings

Our assertion that a non-acquisition policy would result in increased costs to the VA rather than savings can be readily demonstrated using the same FY 1982 statistics used by the Commission in its final report. Under current law, when a VA loan goes into default, the VA can pay the lender the guaranty amount, in which case the VA has no further obligation to the lender, or VA can acquire title to the property and subsequently sell the property to recoup part or all of VA's loss. In FY 1982, the VA acquired 10,150 units. In FY 1982, VA also experienced an average loss on acquired property of $6,700 per unit, for total losses of $68.005 million on the 10,150 units acquired. On the surface it appears that VA could avoid the $6,700 per unit loss by not acquiring properties. However, then VA would be obligated to pay the guaranty on each foreclosed loan. The average guaranty amount for those 10,150 properties VA acquired in FY 1982 was $16,675. Multiplying those two figures produces a total of $169.25 million. Thus, if the non-acquisition policy was implemented, the VA would spend $169.25 million to save $68.005 million. Under current law and regulations governing the Home Loan Guaranty program there are no other options available to VA. Either VA must pay the guaranty amount or it must acquire title to the property and reimburse the lender. The latter option, using the Commission's statistics, cost VA $68 million, the former would have cost $101 million more. We do not understand how the Administration could conclude that the VA could save money employing the former option.

Impact on Veterans

The increase in average claims from $6,700 to $16,675 severely impacts on veterans. The full amount of this payment to lenders is charged as a debt against the veteran and collected by the Government. Currently, in 25 percent or in one of every four cases, the veteran who loses his home is not indebted to the Government because the value of the property equals or exceeds the outstanding loan balance. Instead of this current situation, the Administration's policy change would result in debts being established against all veterans who experience the trauma of foreclosure.

The shift of risk involved in a non-acquisition policy, and any resulting losses to the lending community, would necessarily result in less opportunity for the veteran to obtain housing finance and in higher costs of borrowing for the veteran.

A VA policy of not acquiring foreclosed properties would drastically curtail interest on the part of lenders in investing in VA loans in the future. Those lenders willing to make VA loans would be forced to impose more stringent underwriting requirements on veteran borrowers. Consequently, many veterans who could qualify for financing under the VA's credit guidelines would be unable to satisfy the lender's necessary additional requirements.

One of the most valuable benefits to the veteran of the VA home loan program is the unique no-down payment feature. A veteran may now buy a home with no-down payment, providing his or her income is sufficient to support payments; the VA program is, in fact, the only home mortgage lending program that carries a no-down payment feature. If lenders had to assume an increased risk on default, they would be unwilling to make a VA loan without the equity of a down payment.

If the VA abandons its tradition of accepting title to property, lenders may be forced to try to recover the added losses on VA foreclosures by increasing the discount points to the seller on new loan transactions. Interest rates on conventional and FHA mortgages float with the market and do not require as many discount points.

When the points required to compensate the lender for the recommended change in the VA's policy for acquiring properties are added to the points resulting from the administered VA interest rate, we fear that the veteran will be priced out of the market.

We strongly urge that current VA practice in foreclosure cases remain unchanged. Undoubtedly, there may be ways for the VA to tighten up its property holding and disposition procedures so as to increase the efficiency of its operations and reduce the losses to the Home Loan Guaranty Fund. But any wholesale change in the current practice will not eliminate the problem of losses suffered on disposition of foreclosed properties. We have just been through extremely trying economic times where a sharp increase was seen in both mortgage defaults and foreclosures. It is an unfortunate consequence of the severe recession the country is only now recovering from that the VA Home Loan Guaranty Program has a large inventory of acquired properties at this time. The VA, which has a structure in place to handle property acquisition, maintenance, and disposition, is better equipped than many individual lenders to handle the difficult task of dealing with the lingering effects of the past recession. Preemptorily shifting the burden to private lenders, who in turn will be forced to recover their increased costs from veteran borrowers entering the home market in 1984 and beyond, is an unwise and ultimately shortsighted answer.

Thank you for your consideration.

Sincerely,

Felix M. Beck

Felix M. Beck
President

FMB/en

THE WHITE HOUSE

WASHINGTON

February 27, 1984

Dear Mr. Beck:

Thank you for your recent letter expressing your concerns with a specific recommendation made by one of the Task Forces of the President's Private Sector Survey on Cost Control. Your concerns addressed the VA's Home Loan Guaranty program. The recommendation at issue is that VA cease acquiring properties at foreclosure sales of VA-guaranteed properties and, instead, pay the appropriate amount of the guarantee.

The Administration intends to implement some elements of this recommendation as outlined in the President's fiscal year 1985 Budget. Specifically, we propose to alter VA's procedures for bidding at foreclosure to permit other bidders an opportunity to acquire the property; to curtail the vendee loan program; and to discontinue the sale of mortgage assets with repurchase agreements.

I have enclosed a more detailed discussion both on the issues that you have identified and the rationale behind the changes the President has decided to make in the procedures under which the program operates.

I hope that the attached information appropriately addresses the concerns raised in your letter.

Sincerely,

Craig L. Fuller
Assistant to the President
for Cabinet Affairs

Mr. Felix M. Beck
President
Mortgage Bankers Association
of America
1125 Fifteenth Street, N.W.
Washington, D.C. 20005

Attachment

Prior to responding to the concerns about changing the procedures used to administer VA guaranteed mortgage programs, it is important to note that similar changes are planned for the FHA insured home mortgage program of the Department of Housing and Urban Development (HUD). The Housing and Urban-Rural Recovery Act of 1983, passed last November, includes Section 426, "Payment of Claims Without Acquisition of Title." This section amends Section 204 (a) of the National Housing Act to authorize HUD to pay insurance claims on new contracts for home mortgage insurance without acquiring the property involved. HUD plans to move expeditiously to implement this new authority. Revised regulations will be published by HUD for public comment. We believe this new authority will facilitate the business-like operation of the FHA program for many of the reasons outlined below for the VA program.

Cost Increases. You stated that "...a non-acquisition policy will result in increased costs to the VA rather than savings..." You mentioned that the average cost to VA in fiscal year 1982 of acquiring property for resale was $6,700 per unit, compared with an average guarantee amount of $16,675, and conclude that the new policy would add $9,975 to the average unit cost to VA of making good on guarantee claims.

The Administration believes that your analysis did not consider several important factors:

- VA does not have to pay the total guaranteed amount in lieu of acquiring the property. Instead, VA is required to pay the difference between the foreclosure auction price and the total indebtedness of the veteran to the lender regardless of who acquires the property. Thus, if--in the past--VA's acquisition price represented the market value of the property, there would be no change in VA guarantee payments.

- Your comparison does not consider all costs to the Government, for instance, the cost of Treasury borrowing. In 1982, the year cited in your letter, the average property acquired by VA cost $39,000, and remained in its inventory for 10.3 months. With Treasury borrowing rates averaging 11% in 1982, the interest cost to the Treasury of VA's acquisition was almost $3,700.

- The VA Loan Guaranty program employs approximately 2,000 full-time equivalent staff (over and above contract operations for maintenance and resale of acquired properties), with a budget of $46 million. This expense is financed by appropriations made to VA's General Operating Expenses (GOE) account. While it is difficult to identify precisely the part of those resources devoted to property acquisition and related activities, it is safe to estimate that it is at

least one-third. Thus, savings of $15 million in GOE may be expected from this policy change. This amounts to about $1,500 per property acquired.

- The resale of property acquired by VA generates future costs that add substantially to the $6,700 per unit loss cited in your letter. Almost all of VA's property resales are made through the vendee loan program, whereby VA provides mortgage funds to buyers through direct loans. VA's vendee loans are made on more favorable terms than those of private lenders because they are made at the prevailing VA loan guaranty maximum rate, which is most often somewhat below the market rate. Neither buyer's nor seller's "points" are paid. There is usually no down payment required to obtain these mortgages. (For the past year, VA has further subsidized these loans in a number of locations by charging rates that are 2% lower than the prevailing rate.) Furthermore, the loans are available to anyone who qualifies, regardless of veteran status. The program has thus provided substantial subsidies to nonveteran homebuyers.

  When vendee mortgages are auctioned, they are most often sold at a discount. Thus, the yield to VA is usually substantially less than the nominal value of these loan assets. In 1982, mortgages having a nominal value of $373 million sold for $338 million, an average discount of 9.4%. Applied to the average $39,000 vendee sale, the loss to VA was about $3,700.

  Further, these mortgage assets were sold with "repurchase agreements", under which VA was required to repurchase a mortgage in default or substitute a loan in good standing. Since the program's inception, 13.5% of all vendee loans sold have been repurchased by VA due to default. (In contrast, the default rate on VA guaranteed loans has averaged only 4%). Thus, in the case of vendee asset sales, VA has assumed the total risk (and its cost). We have no way to attribute this cost to the average loss on units VA acquires.

It may take some time for the market to adjust to this change in procedures, because VA's current bidding practices have effectively priced others out of the market. However, once the market has adjusted to this change, we believe that additional amounts, if any, that VA will have to pay on guarantees will be relatively small, and that the eventual elimination of the other cost factors discussed here will make the program less costly to the Government as a whole.

Impact on Veterans. Your second point, that any increases in payments made from the guarantee fund would increase the indebtedness of veterans to VA, is correct. As noted earlier, we do not believe that the average guarantee payment will be the maximum guarantee amount, hence the increase in the veteran's

indebtedness may be less than you would anticipate. However, there is a much more important point: Only about four percent of this debt to VA is ever collected. Therefore, the amount of indebtedness to be incurred is largely academic.

Curtailment of lending. You have indicated that, if VA stops acquiring properties at foreclosure, lenders may be less willing to finance mortgages under this program, and that they would be unwilling to lend without a down payment. However, you have not considered that lenders would be at no greater risk than they are now. Under the existing procedure, the only instances in which VA does not seek to acquire the property are those in which it estimates that payment of the entire guarantee amount would not satisfy the total indebtedness. Thus, when the sum of the amount VA proposes to bid and the maximum guarantee amount, 60% of the mortgage amount up to $27,500, falls short of total indebtedness to the lender, VA does not seek to acquire the property. For this to happen, the decline in property value and the accumulation of lender costs, such as unpaid interest, together, must amount to approximately 50% of the average guaranteed mortgage, a very unlikely situation. However, in that instance, the only one in which the lender would lose, VA's procedures will remain unchanged.

As you know, VA guaranteed mortgages, like FHA insured mortgages, enjoy special status with the Government National Mortgage Association (GNMA) which, through the mortgage-backed securities program, provides unusual liquidity to lenders. We believe that mortgage bankers, recognizing the advantage that this program provides to them, will continue to lend to veterans with VA loan guarantees on substantially the same terms as at present.

There is one final reason for the Administration's change in this program. We believe that the Federal Government should limit its role in the real estate business, which is better left to private enterprise. We are persuaded that VA's role in property acquisition and its methods of disposal have preempted the market forces that should be establishing housing prices, and we have taken this step to restore the marketplace in this segment of our economy.

EXHIBIT 1

VA DOWNPAYMENT CHARACTERISTICS

1983	Number Closed	100% Loans	100% Loans as a Percentage of All Loans Closed
January	9,037	5,186	57%
February	12,689	7,161	56%
March	15,378	8,906	58%
April	13,732	7,830	57%
May	21,863	12,882	59%
June	17,758	10,522	59%
July	15,236	9,018	59%
August	26,608	16,920	64%

1982	Number Closed	100% Loans	100% Loans as a Percentage of All Loans Closed
January	5,472	3,385	62%
February	6,454	3,969	62%
March	6,803	4,236	62%
April	6,074	3,762	62%
May	5,413	3,357	62%
June	7,406	4,431	60%
July	7,257	4,217	58%
August	8,792	5,002	57%
September	11,954	6,457	54%
October	6,088	3,306	54%
November	7,126	3,741	52%
December	8,188	4,422	54%

1981	Number Closed	100% Loans	100% Loans as a Percentage of All Loans Closed
January	16,893	11,945	71%
February	12,799	8,833	69%
March	12,063	8,251	68%
April	13,019	8,875	68%
May	10,193	6,868	67%
June	15,130	10,116	67%
July	11,156	7,105	64%
August	11,677	7,268	62%
September	10,943	6,814	62%
October	8,239	5,167	63%
November	7,759	4,795	62%
December	6,156	3,721	60%

Source: Veterans Administration
Prepared by MBA Economics Department, February 1984

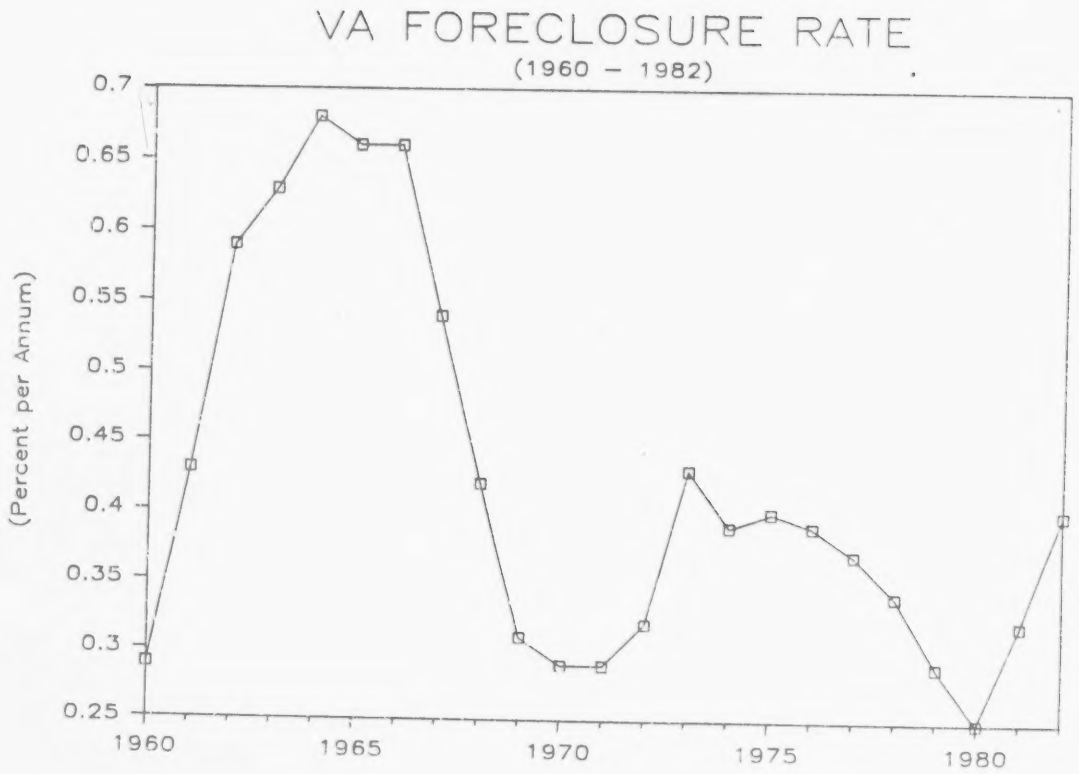
EXHIBIT 2

VA Loans as a Percentage of Total Originations

	$Volume (millions)	Percent
1975	8,836	11.3%
1976	10,426	9.2%
1977	14,882	9.2%
1978	16,026	8.6%
1979	18,838	10.0%
1980	12,102	9.0%
1981	7,509	7.7%
1982	7,687	7.9%
1983 1st quarter	4,473	11.6%
2nd quarter	5,185	9.9%
3rd quarter	5,025	8.7%

Source: Department of Housing and Urban Development's Survey of Mortgage Lending
Prepared by MBA Economics Department, February 1984

CHART I

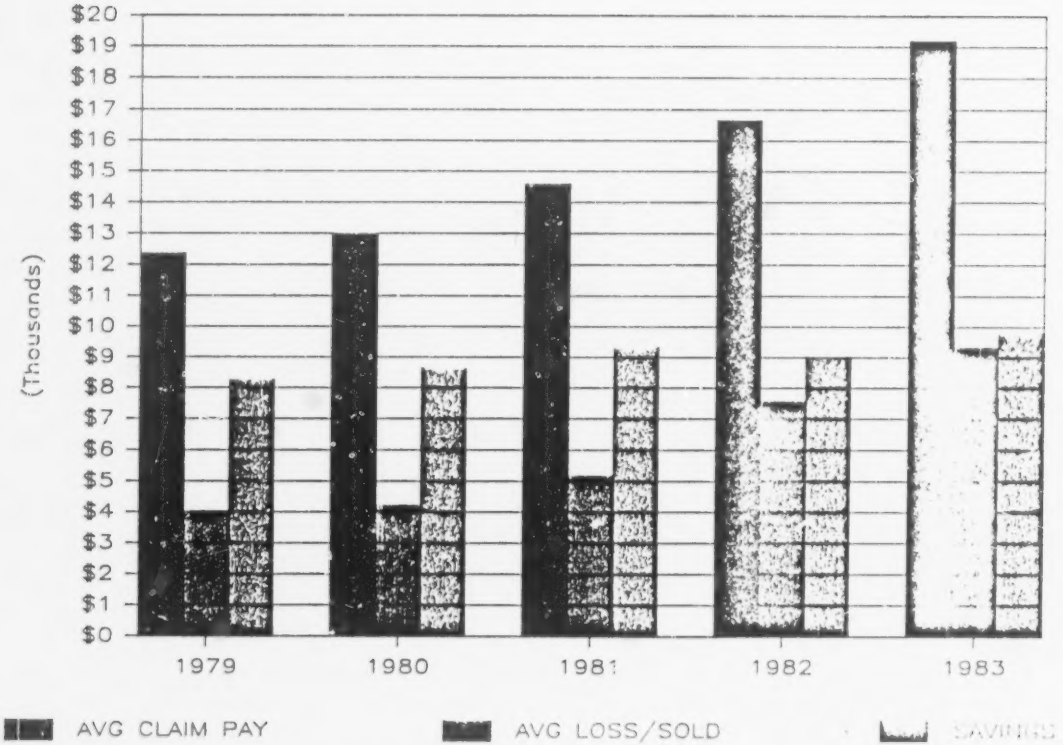


Source: Veterans Administration
Prepared by MBA Economics Department, February 1984

EXHIBIT 3

CHART II

VA ACQUISITION ANALYSIS



Source: Veterans Administration
Prepared by MBA Economics Department, February 1984

EXHIBIT 4

EXHIBIT 5

Mortgage Bankers VA Loan Originations
As a Percentage of Total VA Originations

	Mortgage Bankers $ Volume of VA Originations (billions)	Percent of Total VA Originations
1975	6,326	71.6%
1976	7,381	70.8%
1977	11,624	78.1%
1978	12,372	77.2%
1979	15,506	82.3%
1980	9,567	79.0%
1981	6,044	80.5%
1982	6,158	80.1%
1983 1st quarter	3,470	77.6%
2nd quarter	3,896	75.1%
3rd quarter	3,714	73.9%

Source: Department of Housing and Urban Development, Survey of Mortgage Lending
Prepared by MBA Economics Department, February 1984

	Maximum VA Guaranty	%	Median Sales Prices: Existing Homes	%	New Homes	%	All 1/ Homes	%
1974	17,500	NA	32,000	NA	35,900	NA	35,175	NA
1975	17,500	0.0	35,300	10.3	39,300	9.5	38,576	9.7
1976	17,500	0.0	38,100	19.1	44,200	23.1	43,179	22.6
1977	17,500	0.0	42,900	34.1	48,800	35.9	47,750	35.7
1978	25,000	42.9	48,700	52.2	55,700	55.2	54,510	55.0
1979	25,000	42.9	55,700	74.1	62,900	75.2	61,777	75.6
1980	27,500	57.1	62,200	94.4	64,600	79.9	64,258	82.6
1981	27,500	57.1	66,400	107.5	68,900	91.9	68,518	94.8
1982	27,500	57.1	67,800	111.9	69,300	93.0	69,044	96.3
1983	27,500	57.1	70,300	119.7	75,100	109.2	74,302	111.2

	Maximum VA Guaranty	Price Adjusted VA Guaranty: For Existing Homes	For New Homes	All 1/ Homes	Ratio: Price Adjusted Guaranty To Actual Guaranty: For Existing Homes	For New Homes	All 1/ Homes
1974	17,500	17,500	17,500	17,500	1.00	1.00	1.00
1975	17,500	19,305	19,157	19,192	1.10	1.09	1.10
1976	17,500	20,836	21,546	21,462	1.19	1.23	1.23
1977	17,500	23,461	23,788	23,741	1.34	1.36	1.36
1978	25,000	26,633	27,152	27,119	1.07	1.09	1.08
1979	25,000	30,461	30,662	30,725	1.22	1.23	1.23
1980	27,500	34,016	31,490	31,954	1.24	1.15	1.16
1981	27,500	36,313	33,596	34,089	1.32	1.22	1.24
1982	27,500	37,078	33,781	34,350	1.35	1.23	1.25
1983	27,500	38,445	36,609	36,918	1.40	1.33	1.34

Source: U.S. Department of Commerce, National Assn. of Realtors.
1/ Weighted average of sales prices of new and existing single family homes sold.
Prepared by MBA Economics Department, February 1984

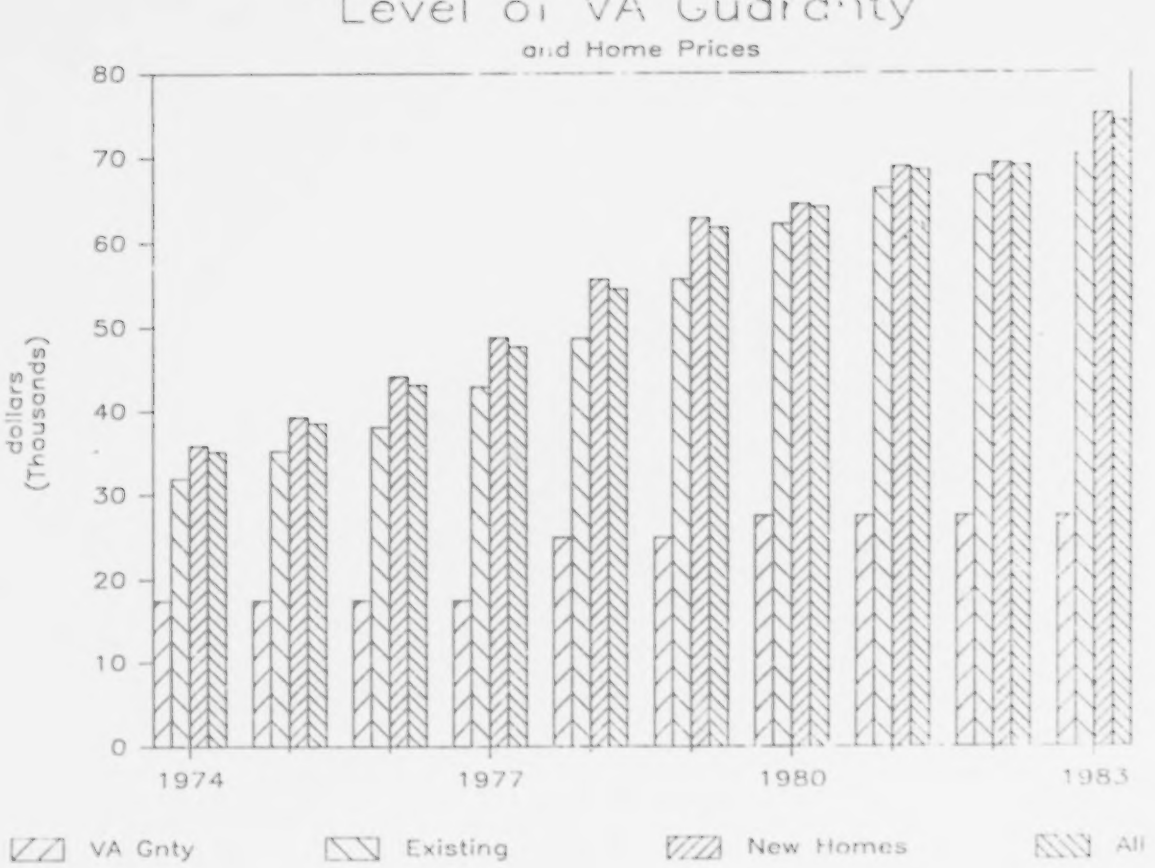

Level of VA Guaranty
and Home Prices
dollars (Thousands)
80
70
60
50
40
30
20
10
0
1974
1977
1980
1983
VA Gnty
Existing
New Homes
All

EXHIBIT 7

Federal National Mortgage Association

FNMA

3900 Wisconsin Avenue, NW, Washington, DC 20016
202 537 6110

obert J. Mylod
esident and
ief Operating Officer

January 17, 1984

Mr. Harry N. Walters, Administrator
Veterans Administration
810 Vermont Avenue, N.W.
Washington, D.C. 20420

Dear Mr. Walters:

We understand that the Veterans Administration is considering changing its claim payment procedures. Under current procedures, VA generally pays the full claim amount and acquires title to the property. As we understand it, the new procedure would have VA pay the guaranteed amount in all cases.

We are very concerned about the impact this change will have on our operation and the acceptability of the VA guaranty. As of October 31, 1983, FNMA owned over 450,000 VA mortgages with current balances totalling $11.2 billion, approximately 11% of the existing VA-guaranteed home loans.

According to the Grace Commission report, VA suffered losses of $6,700 per unit in FY 1982. The Commission projected this average unit loss to $68 million for FY 1983, assuming that VA would acquire 10,150 units during the period. Considering both this assumption and FNMA's 11% share of the outstanding VA mortgages, we could experience additional losses of $7.5 million on VA foreclosures for that same period. Our own estimates, however, indicate that the number of cases affected by the change could be as high as 20,000. In that case, our additional VA losses during the first year could reach $15 million.

We have been an active purchaser of VA mortgages since shortly after the VA loan guaranty program was introduced. In fact, during some tight-money periods, we were virtually the only source for VA mortgage funds. We expect to continue to support the VA programs in the future. Adoption of this change, however, would require us to reexamine our procedures for purchasing VA loans in order to compensate for the expected increase in acquired properties, the additional staff required to manage and dispose of the properties, and the potential for additional losses on VA foreclosures. Available options include requiring conventional appraisals and credit reviews, imposing down payment requirements, and increasing our required rates and loan fees for VA loans. All of these alternatives will increase the cost of housing to veterans.

We are concerned that the proposed changes will have an adverse effect on the loan guaranty program and the veteran homebuyers that it is intended to benefit. Instead, a more reasoned approach could solve the problem while keeping the VA program as an important, positive force in the housing industry. We would be happy to work with VA and other representatives of the mortgage industry to find a resolution that accomplishes your goals without putting an unreasonable burden on the lenders.

So that Members of Congress will be aware of our concerns, we are sending copies of this letter to Representatives G. V. Montgomery and Richard C. Shelby and Senators Alan K. Simpson and Alan Cranston, as well as Robert M. O'Toole of your staff.

Sincerely,

FEB 1 3 1984

Mr. Robert J. Mylod
President and Chief Operating Officer
Federal National Mortgage Association
3900 Wisconsin Avenue, NW
Washington, DC 20016

Dear Mr. Mylod:

This is in reply to your letter of January 17, 1984, concerning a change in VA's loan guaranty claim payment procedures.

The President's Budget for Fiscal Year 1985 requires that, as a matter of policy, VA should not acquire property in connection with the foreclosure of GI home loans. This change in policy was to have been implemented by VA effective in 1984.

VA shares your concern over the possible effects of policy changes.

We are now advised that there will be no general prohibition on acquisition of properties at foreclosure. Rather, we in VA will be working with other Federal agencies involved in insurance or guaranty of home loans to develop a consistent policy with respect to foreclosure procedures which will be applied as general government policy.

I am sure this more positive action toward a national policy alleviates the concerns you have expressed.

Your interest and concern in this matter are appreciated and we look forward to continued participation of the Federal National Mortgage Association in the GI loan program.

Sincerely,

(Signed) Harry N. Walters

HARRY N. WALTERS
Administrator

STATEMENT OF
JOHN F. HEILMAN
NATIONAL LEGISLATIVE DIRECTOR
DISABLED AMERICAN VETERANS
BEFORE THE
SUBCOMMITTEE ON HOUSING & MEMORIAL AFFAIRS
OF THE
VETERANS AFFAIRS COMMITTEE
U.S. HOUSE OF REPRESENTATIVES
MARCH 15, 1984

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

On behalf of the 850,000 members of the Disabled American Veterans, may I say that we appreciate this opportunity to present our views on the Home Loan Guaranty Program of the Veterans Administration.

Mr. Chairman, we commend you most highly for your decision to conduct this oversight hearing. As indicated in your invitation to testify, a major policy change affecting the VA's Home Loan Guaranty Program has been put forth by the Administration. Specifically, it has been proposed that the VA shall commence responding to defaults on home loans guaranteed by the Agency through the paying of the guaranteed portions of loans directly to lenders, rather than by assuming title to properties for future resale (as the Agency has done in the vast majority of foreclosure actions).

First recommended last year by the President's Private Sector Survey on Cost Control, the so-called "Grace Commission", and now

contained in the recently submitted Fiscal Year 1985 budget request of the Veterans Administration, the effects of such a proposed policy change must indeed be given serious scrutiny by you and the members of the Subcommittee.

Would it result in more efficient, more cost-effective operations by the Agency? Equally important to ask, would such a policy change have no ill effects on veteran participants and the fundamental intent of the Home Loan Guaranty Program itself?

Regarding the former question, the VA's Office of Inspector General and the Congressional Budget Office (CBO) have both conducted recent investigations which would appear to offer answers in the negative.

Though by no means sanctioning a VA policy of title acquisition in all cases of foreclosure (CBO was especially critical of the VA's high 95% title acquisition rate), both the Inspector General and CBO indicated that, generally speaking, by acquiring the property and reselling foreclosed mortgages, VA is in fact incurring less of a loss then would be experienced through the blanket payoff of guaranteed portions of loans.

To illustrate this point:

The Inspector General found that in Fiscal Year 1983, the average VA guarantee on foreclosed loans was $18,958.00. Paying lending institutions the guaranteed portions of such loans would, of course, have cost the VA this average amount per default. However, by taking title and subsequently selling properties on the open market, the IG found that the VA was able to reduce this average $18,958.00 loss by almost $4,600.00 (associated foreclosure, property improvement/maintenance and sales costs to the Agency were included in the IG's estimate).

Clearly, the VA should "cut its losses" in this fashion whenever possible.

Using these same dollar figures, Mr. Chairman, one might ask what impact the proposed policy change would have had on the individual veterans involved (some 10,000 VA guaranteed home loans were foreclosed upon by lending institutions in the first six months of 1983 alone).

When a GI home loan is foreclosed upon, the indebtedness incurred by the VA in fulfilling its guarantee obligations -- whether by simple payoff of the guarantee itself to lending institutions or through acquisition of the property -- becomes the veteran's indebtedness to the government.

In 1983, if the VA had paid off the average $18,958.00 guarantee to lenders, the involved veterans would have incurred an indebtedness to the VA for that amount. However, by cutting its losses through title acquisition and later resale of the properties, the VA also reduced the size of these veterans' indebtedness to the government.

Lest the Subcommittee be under the impression that a veteran indebtedness incurred in this fashion is one of "paper", to be borne by the government with little likelihood of recovery, let me hasten to add that this is not the case.

Section 605 of Public Law 96-466, the Veterans Rehabilitation and Educational Amendments Act of 1980, contained several cost savings provisions, one of which broadened the indebtedness recovery authority of the VA and required of the Agency aggressive recoupment actions.

That Section states in part:

> "...the Administrator shall...deduct the amount of the indebtedness of any person who has been determined to be indebted to the United States by virtue of such person's participation in a benefit program administered by the Veterans Administration from future payments made to such person under any laws administered by the Veterans Administration... (underscoring added)

The VA has recently confirmed to the DAV that, in compliance with the provisions of Public Law 96-466, they are now taking such actions in all cases of indebtedness, including those incurred by veterans under the Home Loan Guaranty Program.

Mr. Chairman, the implications are obvious. The proposed policy change would result in a higher indebtedness incurred by veterans -- most likely young Vietnam and post-Vietnam era veterans -- who have just had the disaster of losing their homes befall them. If such veterans would also have entitlement and be in receipt of disability compensation benefits, for example, this greater indebtedness would be recouped from their benefits.

We ask, Mr. Chairman, should the VA embark on a policy that would compound the financial difficulties of this unfortunate category of veterans?

And if the Subcommittee should think that a compassionate waiver of the indebtedness by the Agency might "come to the rescue", one final, ironic twist of fate:

By virtue of a recent Internal Revenue Service directive, the VA is now in the process of gathering information on all indebtedness that have been waived by the Agency, either wholly or in

part, for transmittal to IRS. IRS intends to regard such waived indebtedness as a portion of "gross income" and therefore subject to taxation.

Mr. Chairman, there are other serious "ripple effects" of the proposed policy change that must be considered.

If the policy should go into effect, would private lending institutions in this country be prepared and/or willing to assume the role heretofore played by the VA? If they are not, does this mean that the VA home loan program would become less attractive to private mortgage lenders? And if lending institutions do become "realtors", will the cost of their doing so be borne by veterans in the form of higher interest rates? Hidden "points" and higher closing costs? Are "down payments", the absence of which has been the heart and soul of the VA Home Loan Guaranty Program, now in the offing for veterans?

We do not know the answers to these questions, Mr. Chairman. But, quite frankly, when we consider the origin of the proposed policy change -- the Grace Commission in full zealous pursuit of "privatization" -- we cannot help but conclude that the answers bear no good tidings for the VA Home Loan Guaranty Program or for veterans.

We are aware that OMB has recently informed the Congress that it has "revised" its implementation date for the new policy from March 1 to October 1, 1984. We believe OMB's hesitancy is due primarily to the keen interest displayed by you, Mr. Chairman, the members of your Subcommittee and others who view the VA Home Loan Guaranty Program as a national economic asset and one of the greatest benefits ever provided to America's veteran population.

In summation, Mr. Chairman, let me state that though some changes in the VA's administration of its Home Loan Guaranty Program may be desirable (revision of property acquisition criteria, for example), we most definitely do not believe that the proposed policy, in its present form, should be implemented. We urge that your Subcommittee, either through negotiated agreement with the Administration or through the legislative process of the Congress, insure that the VA will not be required to implement polices and practices that would adversely impact upon the program and its veteran beneficiaries.

Mr. Chairman, this completes my statement. I do thank you for allowing the DAV to participate in these proceedings and I do wish to underscore to you and the Subcommittee how very much our organization appreciates and values the oversight responsibilities that you have demonstrated here today.

Statement of

The American Legion

1608 K STREET, N. W.
WASHINGTON, D. C. 20006

PAUL S. EGAN, DEPUTY DIRECTOR
NATIONAL LEGISLATIVE COMMISSION
THE AMERICAN LEGION

AND

JOSEPH E. MILLER, ASSISTANT DIRECTOR
NATIONAL LEGISLATIVE COMMISSION

BEFORE THE

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
COMMITTEE ON VETERANS AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

ON

GRACE COMMISSION RECOMMENDATIONS
AFFECTING VA HOME LOAN PROGRAM

MARCH 15, 1984

Mr. Chairman and Members of the Committee:

The American Legion appreciates this opportunity to present its views on the VA home loan guarantee program. Given the recent recommendations by the Grace Commission that the VA change its policy with regard to property acquisitions in cases of foreclosure, this hearing could not be more timely.

At first blush, consideration of the Grace Commission findings raises a rather facile and straight forward question: Would the VA accomplish significant savings by taking the Grace Commission's advice? On closer examination, the Grace Commission has raised numerous much more complex questions. These are associated with the solvency of the Loan Guarantee Revolving Fund (LGRF), standard VA practices in foreclosure actions which might be changed to benefit veterans instead of bankers, vulnerability of veterans to foreclosure owing to 100 percent VA indemnification of veterans mortgages. What modifications in the program might be made to allow more veterans to purchase homes despite high interest rates in a latile economy?

What makes these questions all the more complex is their inter-relationship. In this statement we will explore these and other questions and offer a possible solution for the committee's consideration. Before proceeding, we draw the committee's attention to the limitations of the attached nationally adopted Legion resolutions on the subject of the home loan program. With these

resolutions in mind, we offer our best analysis of the present home loan situation.

As you know, this is the third time in as many years that we have discussed with either the House or Senate Veterans Affairs Committee a variety of proposals affecting the home loan program. During this time, The American Legion has had to carefully examine the VA program's relationship with the private sector credit market as well as the real estate industry. In the process we have renewed our respect for one of the few government programs that has managed to remain self sustaining over an extended period. Until recently, the program has been so successful that it has required little more than oversight with slight modifications. The fact that since 1946 over 11 million veterans have been able to use the program to secure mortgages is evidence enough that the program has benefited veterans, the national housing industry and in turn the overall economy.

Over the last 10 to 15 years, however, the ever rising cost of housing, rising interest rates and intermittent recessions have cast serious doubt on the continued ability of the program to fulfill its mission of providing veterans with no money down below market interest rate mortgages. The same changes in housing economics have frustrated the dreams of the now prime home buying aged baby boom generation of Veteran Era veterans. With this in mind, we have to believe that any alterations in the program allowing the pent up demand of this generation of veterans to purchase homes for the first time would set in motion a growth explosion in the housing industry promising millions of new jobs and even broadened growth in the national economy.

Instead, younger veterans whose economic readjustment problems are well documented are frozen out of the housing market. Unacceptably high foreclosure rates among veterans suggest that some of those veterans who have not been frozen out of the market should have been.

In the presence of these high rates of foreclosure the President's Private Sector Survey on Cost Control (PPSSC), otherwise known as the Grace Commission, suggests that savings could accrue to the Loan Guarantee Revolving Fund (LGRF) if the VA retired its guarantee obligations instead of paying off mortgages and acquiring property in foreclosures. Since the VA acquires property in approximately 95 percent of these instances while private mortgage insurers acquire property in only 10-15 percent of instances, it is assumed that the VA is using bad business judgement at the tax payer's expense.

The material available to The American Legion, including a draft report compiled by the Congressional Budget Office (CBO) and a VA Inspector General's report, do not bear out the Grace Commission assumptions. This is because the average loss to LGRF after resale of acquired properties is less than the average loss would be if the VA paid the guarantee instead. From the standpoint of good business judgement, if this is true, the VA should continue the practice of acquiring property.

The Mortgage Bankers Association (MBA) emphatically agrees and strongly urges that the VA continue acquiring foreclosed property. According to the mortgage bankers, if the Grace Commission recommendations are allowed to take effect they "... will restrict the program and reduce the availability of the home loan guarantee

program to veterans, who would otherwise be entitled to participate, but who would not be able to do so if the proposed administrative restrictions are put into effect." They also say, "... lenders will be forced to establish large scale real estate disposition operations, something that they are not now equipped to do." Also, "... many small mortgage lenders who have issued Government National Mortgage Association (GNMA) mortgage-backed securities may not have the reserves that would be required to pay off security holders. These lenders could default on their obligations and go bankrupt." Moreover, "The Task Force recommendations would drastically curtail future interest on the part of lenders in investing in VA loans in the future."

Frankly, Mr. Chairman, we are a bit confused. Are we to believe the bankers when they hold themselves out as spokespersons in behalf of the best interests of veterans while simultaneously threatening to make mortgage money nearly impossible for veterans to obtain if they don't have their way with regard to the Grace Commission recommendations? If we explore the banker's comments which imply that veterans are somehow less credit worthy than other home buyers we find that the current delinquency rate for VA loans is approximately 1 percent lower than the delinquency rate for FHA mortgages and 3 percent higher than for conventional mortgages. However, this 3 percent higher VA delinquency rate is misleading since veterans have experienced a level of unemployment far in excess of the non-veteran population. A year ago the unemployment rate for the general population stood at 10.7 percent. At the same time veterans were faced with 12-13 percent unemployment. If the delinquency rates for VA and conventional loans are

adjusted for the differences in unemployment then the veterans delinquency rate might compare favorably with the delinquency rate for conventional loans. In addition, the data that is most often cited in the comparison of delinquency rates, the "National Delinquency Survey", (NDS) prepared by Mortgage Bankers Association of America (MBAA), is misleading because it compares delinquency rates for 1-4 family unit residential mortgages. But, less than one-half of one percent of all VA home loans are for multiple family residential mortgages. Because of this, the NDS comparisons are, at best, questionable. A more realistic barometer would be to compare only single family unit residential mortgages. Such a comparison might show that veterans have a delinquency rate at or below the delinquency rate for conventional mortgages. The fact is, that demand has been artificially inflated for so long that VA, FHA and conventional home buyers are equally vulnerable financially.

More importantly, what the bankers describe is a situation of financial vulnerability in the mortgage banking industry chillingly similar to conditions on Wall Street at the time of the crash in 1929. The mortgage bankers might be right in their predictions of doom and these same predictions may well constitute a glimpse of what might happen to the entire housing and real estate market if demand for mortgage money is kept artficially high.

In that regard, another of the issues arising out of the Grace Commission recommendations is the question of whether or not bankers and VA are properly qualifying veterans before a certificate of eligibility is awarded and property is purchased. The VA's

current practice of routinely acquiring property instead of liquidating the guarantee obligation provides mortgage bankers with almost no incentive to carefully review the veteran's long term ability to discharge his or her mortgage obligations. This same policy effectively constitutes a 100 percent indemnification of bankers by VA. We have to believe that as long as bankers can rely on the VA to pay off foreclosed mortgages instead of paying off the guarantee, mortgage bankers can continue to enjoy a total absence of risk in their dealings with veterans.

This absence of risk for bankers may be good for some veterans who would otherwise be unable to obtain a mortgage, but for many the same absence of banker risk allows veterans to enter into financial obligations they cannot hope to meet. This may be especially true in economically depressed areas and most certainly true if the veteran's mortgage is the adjustable rate type in which mortgage payments rise sharply ahead of the veteran's income each year.

Moreover, if our suspicions are correct and if veterans were properly qualified before being awarded a guarantee, it would become evident that so few would use the program as to render it near totally useless to the veteran. The problem is especially clear when we consider that only 15 percent of the population can currently afford a $60,000 30 year fixed rate mortgage under present conditions. Given the fact that the average new home is now selling for $75,700 and is expected to rise this year to $81,000, we have serious doubts that very many younger first time home buying veterans will be able to afford homes with or without the VA pro-

gram, unless a few changes are made.

Another broader assumption of the Grace Commission seems to have it that if each government agency directed its programs according to the dictates of sound cost savings business judgement, billions upon billions could be saved. From a micro-economic standpoint with individual programs in mind, the Grace Commission may be correct. However, the programs of the federal government are not business enterprises and the same rules simply do not apply. Instead, federal government programs are established to serve macro-economic and or macro-social ends. These programs are, in effect, the tools with which the federal government executes its public policy decisions.

The VA home loan program was originally established as a readjustment tool to assist veterans in the purchase of homes. Arguably, changes in the program allowing veterans to use the benefit over and over again have taken it out of the sphere of readjustment benefits. Be that as it may, it is still more intended as a tool to assist veterans than a tool to assist bankers. In the past, both ends have been satisfied, but changing economic circumstances have lately tipped the balance away from veterans.

We suggest that decisions made by VA to either acquire property or settle the guarantee in foreclosure instances be made based on the best interests of the veterans the program is supposed to serve. In our view, the VA should closely compare lenders and foreclosure rates to see if there are any lenders with unusually high rates of foreclosure. In such cases VA might well consider banning these lenders from participation in the program. This

step, of course, should be taken only after it has been determined that the lender had or was making loans to veterans likely to default. In lieu of barring lenders from the program, VA might wish to require obligatory forebearance in cases of loans found to have been made contrary to industry standards and against the best interest of the veteran. In cases where the lender is unwilling to cooperate, VA should exercise its option to pay only the guarantee rather than acquire the property. In this way, VA could take a significant step forward in using the VA program as the tool it was intended to be in serving veterans.

The Grace Commission recommendations, in large part, have been spawned by the growing threat that the Loan Guarantee Revolving Fund (LGRF) will soon become insolvent. It is therefore appropriate to make a few observations and comments sbout LGRF with a view toward putting it back on sounder financial footing. A variety of initiatives could be undertaken to accomplish this purpose; some of them would require Congressional approval and some could be done administratively.

Of obvious critical importance to LGRF solvency is effectively reducing the financial drain on it arising from high rates of foreclosure. One initiative to assist in this objective is to provide current veteran home owners with a measure of protection from foreclosure. Last May, the House passed H.R. 2948 which provides home loan foreclosure relief for veterans if, in the Administrator's judgement, the veteran were likely to be able to repay the VA for its assistance. We believe the Senate should follow suit as soon as possible.

On passage of the House bill, it was assumed that the LGRF

would break even if just 40 percent of the veterans assisted repaid the VA. We assume that since much more than 40 percent will repay the VA, the LGRF will save money it would otherwise lose to property acquisition or guarantee liquidation, resale costs and other expenses. Moreover, it is also suggested that if the repayment period were extended beyond that provided for in the House bill, many more veterans would be eligible for the assistance, many more foreclosures would be averted and an even greater percentage of veterans assisted would repay the VA.

Another way of reducing foreclosure which Congress may wish to reconsider is the availability to veterans of adjustable rate mortgages. Part of the rationale for this type of mortgage is that income will increase over time and that homeowners will be able to accommodate higher rates. That reasoning, however, is not supported by the available data.

Income has not kept pace with either rising interest rates or rising housing costs such as utilities and property taxes. In turn, continuing high interest rates have contributed to general economic stagnation, further reducing the likelihood of income increases sufficient to offset mortgage premiums that can raise interest as much as 2 percent each year amounting to a 15 percent increase in mortgage premiums. This condition can only enlarge the potential for more delinquencies and foreclosures.

Since we have not yet gone through a complete business cycle with a large volume of mortgages carrying adjustable or variable rates, no one can accurately predict what will occur during another major recession. Arguments to the contrary notwithstanding, in October of 1983 adjustable rate mortgages including VA, FHA and conventional comprised nearly 50 percent of all mortgages. It is

clear that lenders are moving ahead in this direction, but to whose benefit is unclear.

Standard economics suggest that by increasing the base of mortgage eligibles, more competition is created for limited resources. This serves to perpetuate high interest rates by creating artificially high demand. But for the ability to qualify for a mortgage created by adjustable rates, we wonder whether interest rates and property prices would remain as high as they have. On balance the combination of general economic volatility, unpredictable fuel costs and increasing property taxes make adjustable rate mortgages seem very much like a leap in the dark for the veteran who signs up.

As for the bankers, adjustable rate mortgages have become a necessity. Since, as stated earlier, only 15 percent of the population can comfortably afford today's average priced house at current interest rates (13.5 percent conventional and 12.5 percent VA), it has been necessary to expand the pool of home buying eligibles. In fact, short of adjustable rate mortgage plans, banks have been forced by high interest rates to allow home buyers to qualify for mortgages by permitting an ever growing percentage of disposable income to be devoted to mortgage payments. The percentage of a family's income that can now be used to meet mortgage costs has risen from 25 percent to 36 percent. In this way, lenders have artifically created additional demand for mortgage money.

In other words, mortgage bankers have created additional competition for otherwise idle mortgage money by expanding the base of eligibles to include many who will be unable to meet

the financial obligations, but who by buying anyway keep interest rates artificially high. After having said that, we realize that if the base of eligibles had not been expanded through adjustable rate mortgages and higher income to loan obligations, the financial security of mortgage bankers would have been placed in jeopardy similar to that of savings and loan companies when interest rates began to climb and many of them were left holding billions in low interest bearing long term notes. The point here is not to indict the mortgage bankers, but to suggest that many veterans are and many more can be expected to get into financial trouble if something isn't done to turn things around.

So that there is no misunderstanding about the seriousness of the potential problem, we are well advised to recognize that the lag time between delinquency and foreclosure may mean higher foreclosure rates yet to come even though the most recent recession is all but over. In that regard, many veterans seeking to escape foreclosure by refinancing may fail under the weight of up front financing expenses associated with payments of points and the recently enacted half percent user fee. Nor should we forget that some VA guaranteed mortgages carry interest rates as high as 17.5 percent.

With all of this in mind, we offer yet another suggestion which would require Congressional approval. In order to bring the VA home loan program closer in line with its original readjustment purposes and since most foreclosures involve younger first time home buying veterans, a special program to assist the first time home buying veteran may be in order. We suspect that a special program allowing many of these veterans to purchase homes could be established which would minimize financial vulnerability while simultaneously expanding the housing industry. Such

a program should prove to be attractive to both veterans and lenders and should provide mortgage money at rates even lower than prevailing VA rates. Knowing that investors do not want to hold long term low interest bearing notes, we suggest that such a special program for first time veteran home buyers involve a maximum 60 percent guarantee on unassumable mortgages.

For purposes of discussion, we assume that a veteran buyer wishes to purchase a $65,000 property. Under present circumstances the VA would guarantee $27,500 of the mortgage or 42 percent of the loan value. We will assume that the maximum interest rate that VA will permit is 14 percent on a 30 year fixed rate mortgage. Our suggestion would allow a 5 percent increase in the guarantee for each 1 percent of interest the lender is willing to go below the VA established rate. The following chart illustrates the increase in guarantee for each percent the interest rate is reduced

INTEREST RATE	LOAN VALUE	GUARANTEE	PERCENT GUARANTEED
14%	$65,000	$27,500	42%
13%	$65,000	$30,550	47%
12%	$65,000	$33,800	52%
11%	$65,000	$37,050	57%
10%	$65,000	$40,300	62%

In our example, the lender would be able to reduce the interest rate charged on the loan by 4 percent. This example permits the veterans monthly mortgage to fall from $785.85 to $619.45, a savings of $166.40 per month. On a $65,000 loan with a fixed rate over 30 years the following table illustrates the monthly cost per thousand dollars and interest charge for each percentage of interest.

PERCENT	LOAN VALUE	RATE	MONTHLY COST PER THOUSAND	MONTHLY PRINCIPLE AND INTEREST
14%	$65,000	30 year	$12.09	$785.85
13%	$65,000	fixed	$11.19	$727.35
12%	$65,000		$10.29	$668.85
11%	$65,000		$ 9.53	$619.45
10%	$65,000		$ 8.78	$570.70

Over a one year period the first time home buyer would save $702.00 with a 1 percent reduction, $1,404.00 with a 2 percent reduction, $1,996.80 with a 3 percent reduction and more yet with a 4 percent reduction in the interest rates charged on the loan. This would vastly broaden the pool of eligible first time home buyers by making housing more affordable and without exposing the veteran to the risk of unanticipated foreclosure. We have to believe that the contribution this program would make to reductions in foreclosure offers a meaningful savings to the Loan Guarantee Revolving Fund.

Because such a program might create a disincentive for bankers to deal with veterans other than first time home buyers, we suggest that the guarantee offered by VA be set at 40 percent instead of the lesser of 60 percent or $27,500. Should the VA decide to implement the Grace Commission recommendations, moving to a flat percentage guarantee may become necessary to maintain banker interest in veterans in any event. Apart from this, last year's Congressional action allowing FHA rates to fluctuate with the market also makes it advisable to reinforce banker interest in dealing with the VA program's sub market interest rates.

Yet another suggestion requiring Congressional consideration would also help to refurbish the LGRF. The recently adopted half percent user fee could be redirected away from the Treasury

and into LGRF. According to CBO, "during Fiscal Year 1983, $83.8 million in fees were collected on 236,000 new loans." The CBO has also estimated that the user fee will generate $90 million during FY 84. This money, if redirected to LGRF, would finance 70 percent of the revolving fund's deficit this year. We believe that the balance of the fund's deficit could be offset by requiring stricter qualifying standards for veterans before they purchase properties and by reducing the number of properties acquired by VA during any given year.

There are additional steps the VA could take administratively to generate savings in the LGRF. These too would make the home loan program a stronger policy execution tool to assist veterans. Last year, for example, we discussed with this committee the possibility of permitting VA loans to be made for rehab housing. Rehab housing provides the opportunity for veterans to acquire housing at a substantial savings. We were led to believe that the VA could institute a rehab housing policy without the need for legislation. However, to our knowledge, nothing has been done by the VA in this regard and legislation may indeed be necessary to make such a program a reality.

At the same time, the VA should develop economies by pursuing a program of property disposal that would include actively promoting properties to veterans wishing to purchase a home. The purchase of inventoried property by veterans would mean that money loaned by the VA would go to a deserving veteran instead of someone outside the VA loan guaranty eligibility sphere, including those who may never have served.

In fact, if the VA were to deal directly with veterans without using real estate agents or companies, additional money could be saved on commission expenses. The commission costs to the revolving fund for the property held only in this region will total nearly $137,000. Moreover, the VA has administrative efficiencies available to it that can substantially reduce the revolving fund deficit and also help veterans. And helping veteran is the reason the VA and the home loan program were established in the first place.

Mr. Chairman, that concludes our statement.

SIXTY-FIFTH ANNUAL NATIONAL CONVENTION
OF
THE AMERICAN LEGION
AUGUST 19-25, 1983
SEATTLE, WASHINGTON

RESOLUTION NO. : 368

COMMITTEE : ECONOMICS

SUBJECT : SUPPORT VETERANS ADMINISTRATION HOME LOAN PROGRAM

WHEREAS, The VA home loan program, as a benefit available to veterans who served their country honorably, has provided over 11 million veterans with the opportunity to own their own homes; and

WHEREAS, Because of changing economic conditions and the very volatile nature of the real estate market, many hundreds of thousands of Vietnam era veterans have been unable to purchase their first homes; and

WHEREAS, The home loan program has operated successfully under the Veterans Administration since its inception in 1944; now therefore be it

RESOLVED, By The American Legion in National Convention assembled in Seattle, Washington, August 23, 24, 25, 1983, that The American Legion support all legislation that will have a positive impact on the VA home loan program; and be it further

RESOLVED, That The American Legion oppose any attempt to remove this home loan program for veterans from the VA.

SIXTY-FIFTH ANNUAL NATIONAL CONVENTION
OF
THE AMERICAN LEGION
AUGUST 19-25, 1983
SEATTLE, WASHINGTON

RESOLUTION NO. : 382

COMMITTEE : ECONOMICS

SUBJECT : SUPPORT LEGISLATION TO ALLOW THE VETERANS ADMINISTRATION TO GUARANTEE LOANS FOR THE PURCHASE AND RENOVATION OF HOUSES NEEDING REHABILITATION

WHEREAS, The VA home loan program is a benefit available to all veterans who served their country honorably, providing over eleven million veterans with the opportunity to purchase their own homes; and

WHEREAS, Many younger veterans, particularly those of the Vietnam era, have been unable to purchase their first homes due to high mortgage principal and interest rates; and

WHEREAS, Housing needing rehabilitation, known as rehab housing, can often be purchased and renovated more cheaply than homes that already meet existing housing codes; and

WHEREAS, There is currently no provision in the VA home loan program for the purchase and renovation of this type of housing, now therefore be it

RESOLVED, By The American Legion in National Convention assembled in Seattle, Washington, August 23, 24, 25, 1983, that The American Legion support legislation that would allow the Veterans Administration to guarantee loans for the purchase and renovation of houses needing rehabilitation.

Mortgage Bankers Association of America

John M. Robertson
President
(202) 861-1930

December 15, 1983

The Honorable G. V. Montgomery
Chairman
Committee on Veteran's Affairs
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

The Administration is threatening to change the Veterans' Home Loan Guaranty Program in a significant and harmful way, by fiat, without Congressional direction and public discussion. While the exact time of implementation of this change is not definite, the Mortgage Bankers Association of America (MBA) is concerned that it is imminent. MBA respectfully urges you, as Chairman, and the other members of the Committee on Veterans' Affairs, to take appropriate action to prevent the Veterans' Administration (VA) from abandoning an element of the VA loan guaranty program that has been used effectively for many years and that is important to the ability of veterans to own their own homes.

VA Home Loan Guaranty Program

The VA home loan guaranty program was established by Congress as an entitlement program. Every veteran meeting the program's requirements should be entitled to the guaranty of his or her home mortgage, as provided by statute. Administrative implementation of the Task Force's proposal will restrict the program and reduce the availability of the home loan guaranty program to veterans, who otherwise would be entitled to participate, but who would not be able to do so if the proposed administrative restrictions are put into effect. MBA urges Congress not to allow this administrative restriction of an entitlement program.

The VA home loan guaranty program is one of the most successful housing programs in this Nation's history. Approximately 11 million veterans have been housed with VA-guaranteed loans. In FY 1982, 92,930 new loans were guaranteed and in FY 1983, the volume rose to 231,620. Mortgage bankers have always been heavily involved in the VA home loan guaranty program. During the last decade, mortgage bankers originated approximately 76 percent of all VA-guaranteed loans.

In order to encourage lender participation in the VA loan guaranty program, minimize administrative costs, and retain the flexibility to allow a deserving veteran to remain in the family home even after mortgage default, the VA has traditionally and wisely accepted title to the property in most foreclosure cases. Now, apparently under pressure from the Office of Management and Budget (OMB), the VA may refuse to acquire title to homes securing mortgages that have gone into default. Rather, the VA would respond to defaults by paying loan holders the guaranteed portion

of the loan, leaving the lender to dispose of the property. This proposal, which originated with a Task Force of the President's Private Sector Survey on Costs, should be reviewed by your Committee and the Congress and not allowed to be implemented without that Congressional review.

Problems for Lenders

If the VA accedes to the Task Force recommendation and no longer acquires properties, mortgage lenders will be forced to establish large scale real estate disposition operations, something that they are not now equipped to do. The VA's current practice of acquiring the vast majority of foreclosed properties allows the VA to spread its losses. The VA loses money on the disposition of some properties and breaks even or gains on the sale of others. Most mortgage lenders' operations are not sufficiently large to allow for the spreading of this risk. Lenders with large concentrations of properties in depressed areas would suffer devastating losses on the disposition of foreclosed properties in these areas.

Additionally, many small mortgage lenders who have issued Government National Mortgage Association (GNMA) mortgage-backed securities may not have the reserves that would be required to pay off security holders. These lenders could default on their obligations and go bankrupt.

Impact on Veterans

The shift of risk recommended by the Task Force and the resulting losses to the lending community must necessarily result in less opportunity for the veteran to obtain housing finance and in higher costs of borrowing for the veteran.

The Task Force recommendation would drastically curtail future interest on the part of lenders in investing in VA loans in the future. Those lenders willing to make VA loans would be forced to impose more stringent underwriting requirements on veteran borrowers. Many veterans who could qualify for financing under the VA's credit guidelines would be unable to satisfy the lender's necessary additional requirements. Currently, it is the VA's policies that determine which veterans qualify for financing. However, if the losses that result from borrowers' defaults are shifted to the lender, the policy for determining which veterans qualify for financing will be assumed by the private sector.

One of the most valuable benefits to the veteran of the VA home loan program is the unique no-down payment feature. A veteran may now buy a home with no-down payment, providing his or her income is sufficient to support payments; the VA program is, in fact, the only home mortgage lending program that carries a no-down payment feature. If lenders had to assume an increased risk on default, they would be unwilling to make a VA loan without the equity of a down payment.

If the VA abandons its tradition of accepting title to property, lenders will be forced to try to recover the added losses on VA foreclosures by increasing the discount points to the seller on new loan transactions. Interest rates on conventional and FHA mortgages float with the market and do not require as many discount points.

When the points required to compensate the lender for the recommended change in the VA's policy for acquiring properties are added to the points resulting from the administered VA interest rate, we fear that the veteran will be priced out of the market.

The VA home loan guaranty program should not be tampered with capriciously. Such a fundamental change, as is proposed, should be the subject of hearings before it is implemented, even though statutory authority now technically rests with the VA to make the change.

MBA urges that Congress act quickly to defer implementation of the Task Force recommendation until Congress has had an opportunity to investigege the possible adverse effects upon the veteran homebuyer. Please accept our appreciation for your courtesy in this matter.

Sincerely,

Felix M. Beck

Washington, D.C. 20005

Mortgage Bankers Association of America

Sylvia M. Beck, CMB
President
(202) 861-1900

January 11, 1984

Mr. Craig Fuller
Assistant to the President for
Cabinet Affairs
The White House
Washington, D. C. 20500

Dear Mr. Fuller:

On behalf of the Mortgage Bankers Association of America, I am writing to you in your capacity as coordinator for the implementation of the recommendations of the President's Private Sector Survey on Cost Control (Grace Commission) to express our opposition to implementation of a recommendation that was made by a Commission Task Force but was not adopted by the Commission, that we believe will change the Veterans Administration's (VA) Home Loan Guaranty Program in a significant and harmful way.

In the draft report of the Commission's VA Task Force, a tentative recommendation was made that the VA Home Loan Guaranty Program change its customary practice of acquiring title to most foreclosed properties securing VA guaranteed loans and, instead, pay the guaranty amount. As the originators of the bulk of all VA guaranteed loans, when we became aware of this tentative recommendation in May, we wrote to the Commission expressing our opposition. We believe that if this change in current practice was made, there would be an increase, rather than a decrease, in costs to the VA, and the change could very well result in a diminished and more costly supply of mortgage credit for veteran borrowers.

The Commission then modified the Task Force recommendation prior to including it in the final Commission report to the President. The final recommendation of the Commission is that VA acquire properties at foreclosure sales only when it is in the best interest of the taxpayers. The report does qualify this recommendation, however, with the statement that property should only be acquired in a true exception situation when justification can be made on a case-by-case basis. We believe that VA is following such a practice currently in foreclosure cases and that the economics in most situations compel the decision by VA to acquire the property for subsequent re-sale as a way of reducing potential losses.

It is our understanding, however, from press reports that the Administration has determined that VA should cease acquiring properties in all or almost all foreclosure situations and simply pay the guaranty amount, as was recommended tentatively by the Commission's VA Task Force.

Cost Increases Rather Than Savings

Our assertion that a non-acquisition policy would result in increased costs to the VA rather than savings can be readily demonstrated using the same FY 1982 statistics used by the Commission in its final report. Under current law, when a VA loan goes into default, the VA can pay the lender the guaranty amount, in which case the VA has no further obligation to the lender, or VA can acquire title to the property and subsequently sell the property to recoup part or all of VA's loss. In FY 1982, the VA acquired 10,150 units. In FY 1982, VA also experienced an average loss on acquired property of $6,700 per unit, for total losses of $68.005 million on the 10,150 units acquired. On the surface it appears that VA could avoid the $6,700 per unit loss by not acquiring properties. However, then VA would be obligated to pay the guaranty on each foreclosed loan. The average guaranty amount for those 10,150 properties VA acquired in FY 1982 was $16,675. Multiplying these two figures produces a total of $169.25 million. Thus, if the non-acquisition policy was implemented, the VA would spend $169.25 million to save $68.005 million. Under current law and regulations governing the Home Loan Guaranty program there are no other options available to VA. Either VA must pay the guaranty amount or it must acquire title to the property and reimburse the lender. The latter option, using the Commission's statistics, cost VA $68 million, the former would have cost $101 million more. We do not understand how the Administration could conclude that the VA could save money employing the former option.

Impact on Veterans

The increase in average claims from $6,700 to $16,675 severely impacts on veterans. The full amount of this payment to lenders is charged as a debt against the veteran and collected by the Government. Currently, in 25 percent or in one of every four cases, the veteran who loses his home is not indebted to the Government because the value of the property equals or exceeds the outstanding loan balance. Instead of this current situation, the Administration's policy change would result in debts being established against all veterans who experience the trauma of foreclosure.

The shift of risk involved in a non-acquisition policy, and any resulting losses to the lending community, would necessarily result in less opportunity for the veteran to obtain housing finance and in higher costs of borrowing for the veteran.

A VA policy of not acquiring foreclosed properties would drastically curtail interest on the part of lenders in investing in VA loans in the future. Those lenders willing to make VA loans would be forced to impose more stringent underwriting requirements on veteran borrowers. Consequently, many veterans who could qualify for financing under the VA's credit guidelines would be unable to satisfy the lender's necessary additional requirements.

One of the most valuable benefits to the veteran of the VA home loan program is the unique no-down payment feature. A veteran may now buy a home with no-down payment, providing his or her income is sufficient to support payments; the VA program is, in fact, the only home mortgage lending program that carries a no-down payment feature. If lenders had to assume an increased risk on default, they would be unwilling to make a VA loan without the equity of a down payment.

If the VA abandons its tradition of accepting title to property, lenders may be forced to try to recover the added losses on VA foreclosures by increasing the discount points to the seller on new loan transactions. Interest rates on conventional and FHA mortgages float with the market and do not require as many discount points.

When the points required to compensate the lender for the recommended change in the VA's policy for acquiring properties are added to the points resulting from the administered VA interest rate, we fear that the veteran will be priced out of the market.

We strongly urge that current VA practice in foreclosure cases remain unchanged. Undoubtedly, there may be ways for the VA to tighten up its property holding and disposition procedures so as to increase the efficiency of its operations and reduce the losses to the Home Loan Guaranty Fund. But any wholesale change in the current practice will not eliminate the problem of losses suffered on disposition of foreclosed properties. We have just been through extremely trying economic times where a sharp increase was seen in both mortgage defaults and foreclosures. It is an unfortunate consequence of the severe recession the country is only now recovering from that the VA Home Loan Guaranty Program has a large inventory of acquired properties at this time. The VA, which has a structure in place to handle property acquisition, maintenance, and disposition, is better equipped than many individual lenders to handle the difficult task of dealing with the lingering effects of the past recession. Preemptorily shifting the burden to private lenders, who in turn will be forced to recover their increased costs from veteran borrowers entering the home market in 1984 and beyond, is an unwise and ultimately shortsighted answer.

Thank you for your consideration.

Sincerely,

Felix M. Beck
President

FMB/en

VETERANS OF FOREIGN WARS OF THE UNITED STATES

OFFICE OF THE DIRECTOR

STATEMENT OF

JAMES N. MAGILL, SPECIAL ASSISTANT
NATIONAL LEGISLATIVE SERVICE
VETERANS OF FOREIGN WARS OF THE UNITED STATES

BEFORE THE

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
COMMITTEE ON VETERANS' AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

WITH RESPECT TO

VETERANS ADMINISTRATION HOME LOAN GUARANTY PROGRAM

WASHINGTON, D. C. MARCH 15, 1984

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

Thank you for the opportunity to present the views of the Veterans of Foreign Wars of the United States relating to the Veterans Administration Home Loan Guaranty Program. The VFW is appreciative of the Chairman for holding this hearing, demonstrating his and the Subcommittee's continuing concern for our nation's veterans. We would also like to take this opportunity to commend you, Mr. Chairman, for your efforts in attempting to restore solvency to the VA Loan Guaranty Revolving Fund by requesting that $108 million be appropriated in FY 85 for this activity.

Mr. Chairman, the VFW considers the VA Home Loan Guaranty Program as one of the most successful and beneficial programs available to veterans. This popularity is evidenced by the fact that just last year the VA approved its 11 millionth loan and, according to the VA, home purchases by veterans and active duty service members under the VA Home Loan Program more than tripled in 1983 over 1982. We

believe this program should continue to enjoy the full support of the Congress and the Administration.

Mr. Chairman, as stated previously we are concerned with the solvency and the future of the VA Loan Guaranty Revolving Fund. The rapid depletion of this fund, brought about by the high foreclosure and VA property acquisition rate over the last few years, may soon require an emergency request for additional funding. In part, because of this high foreclosure rate, the Administration is proposing the VA implement a "Grace Commission" recommendation and opt as policy to pay off the guaranteed portion of a loan during foreclosure proceedings and permit the lender to take possession of the property in order to reduce VA property inventory and acquisition costs. Information available to us indicates that while in the short-run this proposal certainly does appear cost-effective, in the long-run it would prove more costly to the VA. Under current VA foreclosure proceedings the VA most often pays the lender an average of $58,000 and takes possession of the property, but, after resale, the VA suffers an average loss of $9,500 per house. By just paying the guaranteed amount of the loan, the VA would expend approximately $19,500 per property. However, one must not be misled by the "Grace Commission" recommendation in that while showing a reduced VA outlay from $58,000 to $19,500 for the next few years, once all VA properties have been disposed of the VA will be averaging an outlay of $19,500 per house instead of the current net loss of $9,500. In addition, the VA would lose a source of income derived from holding these properties. One must not look for the short-term solution but seek a re-solution which will be long-lasting. We believe the VA would be very short-sighted to dissolve itself of and cease acquisition of all properties to show a "quick-fix" while foregoing a proven source of income for the revolving fund.

We also believe the implementation of this particular "Grace Commission" re-

commendation could be detrimental to veterans seeking a VA guaranteed home loan. According to the Mortgage Bankers Association, the adoption of the Commission recommendation may cause veterans to suffer by bringing about higher down payment requirements in addition to causing higher income standards to be met along with higher loan origination points. Certainly, the primary group effected by these actions would be Vietnam veterans attempting to purchase their first home.

While in our opinion there may be no one clear-cut answer to resolving the financial problems of the Revolving Fund, we believe the compromising of the many proposed solutions could prove productive. Again, one suggestion we believe should be considered is the returning of funds generated by the "users fee" on new VA loans to the VA rather than the general treasury. While we recognize that these are "cost-savings" funds and their return to the VA would require the imposition of similar cost-savings in other programs, it is ironic to us that funds raised specifically from the veteran population cannot be used for the benefit of veterans seeking like benefits. Instead we are faced with the prospect of seeking increased appropriations from the Congress in order to resolve the same difficulties.

Mr. Chairman, as we stated previously no single solution will solve the problems facing the Revolving Fund and likewise no one institution should singularly shoulder the blame for the current situation. While the banking community may want to more closely scrutinize a loan applicant's ability to meet the responsibilities of a home loan, the VA at the same time may want to be more discretionary in which properties it decides to acquire. We belive the recent economic conditions should also be taken into consideration when assessing the plight of the revolving fund. Had unemployment not been at such staggering levels, certainly the amount of VA home acquisitions would not be so high. I am sure Mr. Chairman, you will agree the bottom line is providing for veterans the best possible opportunity for homeownership. With economic improvement and the Mortgage Banking

Community and VA working together in attempting to keep veterans in their homes during periods of hardship, all participants in the process will benefit.

With respect to the effect of last year's Congressional action freeing the FHA interest rate on the VA Home Loan Guranty Program, we believe it is too premature to make an accurate assessment. Currently, the housing market is strong and it appears the recovery will continue. However, should the market decline and become tight, we foresee the assigning of higher points and lenders being more reluctant to grant loans under the VA program.

Mr. Chairman, appended to my statement are a number of resolutions, adopted at our most recent National Convention addressing issues pertinent to this hearing. They are:

Resolution No. 620 entitled "VA Home Loan Assistance"

Resolution No. 713 entitled "Investigate Appraisal Fee and Points For GI Loans"

Resolution No. 770 entitled "Veterans Administration Home Loans"

This concludes my statement. I will be happy to respond to any questions you may have.

RESOLUTION No. 620

VA HOME LOAN ASSISTANCE

WHEREAS, the current depressed state of the economy has brought about increasing unemployment among veterans; and

WHEREAS, high unemployment has caused veterans, as well as others, to be forced from their homes because of their inability to meet payments on them; and

WHEREAS, we believe veterans should receive priority assistance that will enable them to maintain payments on and keep their homes; and

WHEREAS, the Administrator of Veterans Affairs is authorized to assist veterans, through various means, to keep their homes; now, therefore

BE IT RESOLVED, by the 84th National Convention of the Veterans of Foreign Wars of the United States, that the Administrator of Veterans Affairs be actively encouraged to liberally assist veterans to keep their homes; and

BE IT FURTHER RESOLVED, that we seek the introduction and passage of legislation to expand the authority of the Administrator to assist veterans to keep their homes during periods of high unemployment

Adopted by the 84th National Convention of the Veterans of Foreign Wars of the United States held in New Orleans, Louisiana, August 17-19, 1983.

Resolution No. 620

Resolution No. 713

INVESTIGATE APPRAISAL FEE AND POINTS FOR GI LOANS

WHEREAS, the appraisal fee charged to veterans on GI Home Loans has tripled that which was charged World War II veterans; and

WHEREAS, many of the appraisals made by the GI Home Loan appraisers are a duplicate of that made by the lending institutions; and

WHEREAS, the points charged to the seller on a GI Home Loan is only passed on to the veteran; and

WHEREAS, many veterans who have GI Home Loans and had paid the additional points and have an opportunity to re-finance at a much lower rate of interest are now being charged additional points that make the cost of financing far beyond reason; and

WHEREAS, the GI Home Loan program was intended to assist the veteran in purchasing a home at a lower rate of interest; and

WHEREAS, the charging both the seller and the veteran the interest points that are of direct benefit to the lender; and

WHEREAS, the duplication of charges for appraisal fees provides a hardship to the veteran attempting to purchase a home; now, therefore

BE IT RESOLVED, by the 84th National Convention of the Veterans of Foreign Wars of the United States, that we request the Veterans Administration or the Congress of the United States to investigate the procedures used in establishing appraisal fees, appraisal assignments and the determination of the points charged on GI Home Loans that prove to be an overcharge to the veteran and are not in accordance with the original intent of the GI Home Loan program.

Adopted by the 84th National Convention of the Veterans of Foreign Wars of the United States held in New Orleans, Louisiana, August 12-19, 1983

Resolution No. 770

VETERANS ADMINISTRATION HOME LOANS

WHEREAS, legislation is advancing in the Congress whereby Federal Housing Administration (FHA) loans will bear a local buyer/lender negotiated rate of interest instead of a nationally fixed rate; and

WHEREAS, the passage of such legislation would serve to make Veterans Administration (VA) fixed rate home loans substantially less attractive to sellers and lenders; and

WHEREAS, VA home loans are a substantive part of the benefits "package" afforded those who have honorably served their nation in the Armed Forces; and

WHEREAS, the maintenance of a competitive and viable VA home loan program is very necessary in order for veterans to continue to receive meaningful benefits in recognition of their service; and

WHEREAS, changes in the VA home loan program such as granting the VA Administrator the ability to (a) independently set VA home loan rates; (b) exercise greater latitude in the VA home loan guarantee percentage/maximum amount; (c) authorize veterans the option to engage the service of a buyer broker; (d) authorize the subsidization of VA home loan interest rates, and other program improvements, may strengthen that program; now, therefore

BE IT RESOLVED, by the 84th National Convention of the Veterans of Foreign Wars of the United States, that we seek the introduction and passage of legislation that will serve to maintain the VA home loan program as the most viable and desirable means of home financing available.

Adopted by the 84th National Convention of the Veterans of Foreign Wars of the United States held in New Orleans, Louisiana, August 12-19, 1983.

Resolution No. 770

STATEMENT OF

BOB MORAN, ASSOCIATE LEGISLATIVE DIRECTOR

PARALYZED VETERANS OF AMERICA

BEFORE THE

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS

OF THE

HOUSE COMMITTEE ON VETERANS' AFFAIRS

CONCERNING

OVERSIGHT OF THE VA HOME LOAN GUARANTY PROGRAM

MARCH 15, 1984

Mr. Chairman and Members of the Subcommittee, on behalf of the members of Paralyzed Veterans of America I wish to thank you for this opportunity to present the views and concerns of PVA regarding the Veterans Administration Home Loan Guaranty Program.

PVA would personally like to commend you, Mr. Shelby, as Chairman of this Subcommittee, for holding this hearing, and for your insightful leadership. Additionally, we wish to further compliment you and each individual member of this Subcommittee for your ongoing efforts to improve the effectiveness of this important benefit that affects so many of our nation's veterans.

801 Eighteenth St., N.W., Washington, D.C. 20006 (202) USA-1300

VA "Home Loan Guaranty" is an entitlement program, with every veteran meeting the requirements, as provided by statute, being eligible for the guaranty of their mortgage. Since its inception in June 1944, the VA Home Loan Guaranty Program has assisted 11 million veterans and their families in gaining suitable, affordable housing.

It has been one of the most successful housing programs in this nation's history, and despite the size of the program it has cost the Federal government very little. Without a doubt, the VA Home Loan Guaranty Program has been a good investment in America, providing stability and expanding the tax base of nearly every community in our country.

Currently, when a VA guaranteed loan goes into default and is foreclosed, the VA has the option to either pay the outstanding balance due on the loan plus costs incurred through foreclosure, (lesser of $27,500 or 60 percent of outstanding amount) or to acquire the title to the property. Traditionally, in most cases, the VA has accepted title to the property. This was done in order to encourage lender participation in the VA Home Loan Guaranty Program, to minimize administrative costs, and to retain flexibility to allow a deserving veteran to remain in the family home even after mortgage default.

Now, it appears efforts are underway to change this program so that the VA will refuse to acquire titles to homes that have gone into default. This provision, in the President's budget, came from a recommendation of the President's Private Sector Survey on Cost Control (PPSSCC) - Report on the Veterans Administration. This proposal eliminates property acquisitions

following foreclosures, refunds to preclude foreclosures, and repurchasing of sold loans.

With the VA responding to defaults in this manner, paying the guaranteed portion, it would leave the lender to dispose of the property. Additionally, vendee loans will be discontinued on the properties remaining in the VA inventory, which are to be sold as quickly as possible. PVA's concern is, that if the Grace Commission recommendation is implemented, it will ultimately be the veteran who is the recipient of any increased costs for VA loans.

Mr. Chairman, I would like to reiterate from a letter sent to you on February 14, 1984, from the American Bankers Association, which represents 90 percent of this nation's banks. They stated that, "restricting the VA to paying the guaranty portion on foreclosed properties will undoubtedly be perceived by lenders, servicers of loans, investors in VA loans, and the securities backed by VA loans, as increasing their risk exposure to losses incurred in the disposition of such properties. This increased risk, when coupled with the additional real cost increases to be realized for loan servicing and property disposition, could result in lenders accessing higher fees and other charges for originating VA loans."

Those lenders willing to make VA loans would be forced to impose more stringent requirements on the veteran borrower. Veterans, who now qualify for financing under the present VA Home Loan Guaranty Program's credit guidelines, could be faced with not being able to satisfy the lenders necessary additional requirements.

Presently, it is the VA's policies that determine which veterans qualify for financing. If the losses resulting from borrowers' defaults are shifted to the lender, the policies for determining which veterans qualify for financing will also be assumed by private lenders.

Lenders may also refuse to accept applications from veterans with no money down, opting to demand some equity in investment from the veteran. This feature, of no money down, has been one of the most valuable benefits in the VA Home Loan Guaranty Program. A veteran may now buy a home with no downpayment, providing his or her income is sufficient to support payments; the VA's home loan program is the only home lending program that carries this feature.

The Mortgage Bankers Association of America, which has been heavily involved in the VA Home Loan Guaranty Program, having originated approximately 76 percent of all VA guaranteed loans, has stated in a letter to Chairman G.V. (Sonny) Montgomery, dated December 15, 1983 that: "If lenders had to assume an increased risk on default, they would be unwilling to make a VA home loan without the equity of a downpayment." This proposed action would place a heavy burden on veterans and would greatly diminish the efficacy of the VA home loan program.

Another concern of PVA is that if the VA abandons its tradition of accepting title to properties, lenders will be forced to try to recover the added losses of VA foreclosures by increasing the discount points to the seller on new loan transactions. When the points required to compensate the lender for the recommended change in the VA's policy are added to the points resulting

from the administered VA interest rate, again, it would be the veteran as the recipient of this increased cost, being forced out of the home buying market.

In addition, PVA is concerned about the status of the VA Home guaranty revolving fund. Until recently, this program has been self-supporting since its inception in 1944. Due to the recent unprecedented high rate of unemployment, the highest interest rates in history and the recent economic recession which have resulted in a high rate of loan defaults and foreclosures the revolving fund is currently not self-supporting. PVA believes that the funding fee charged veteran borrowers should be allocated back to the VA, instead of the treasury general fund, for use in maintaining the revolving fund.

Returning such funds from the VA's Home Loan Guaranty Program back to the VA is the same method used by the Federal Housing Authority (FHA). FHA Mortgage Insurance premiums are being directed back to operate the FHA Home Loan Mortgage Insurance Program. Presently, the veteran borrower, who has earned his eligibility for the VA program, is providing general revenues for the Federal government, rather than having the monies returned to support the revolving fund.

Veterans' use of the VA Home Loan Guaranty Program, like that of the private sector housing programs, is directly related to the general economic conditions, and veterans, like all Americans, have been adversely impacted. We believe that as the economy continues to ease out of the recession, and interest rates moderate, the rate of defaults and foreclosures will decline as will the drain on the revolving fund.

33-959 O—84——11

In Fiscal Year 1983, 85 percent of the VA loans reported as being in default were brought current, and we applaud the efforts of the VA loan service representatives at the VA Regional Offices for this accomplishment. PVA believes that the VA Home Loan Guaranty Program has and continues to serve veterans well, giving the veteran borrower the opportunity to secure a low-cost loan, with no downpayment, thereby fulfilling the American dream of owning a home.

In summary, Mr. Chairman, while PVA has been led to understand that the proposed October 1, 1984, implementation date for this new policy is tentative, we are uncertain whether such action should ever be taken. Several critical questions have not been answered satisfactorily by the Administration regarding the potential effect such an action might have on the nation's veterans. If this proposal were to be implemented, will potential lenders be as willing to finance homes purchased by veterans. Will foreclosures be accelerated to the detriment of veterans. And, will there be a resultant windfall of profits to be made by private mortgage lenders and insurers at the expense of veterans and the VA. These questions must be answered during consideration of this proposal. A thorough review of this potential action must be made prior to its implementation. And, if such action is to be imposed, it should be government-wide. Veterans must not be used as a test to determine the viability and cost effectiveness of this proposal.

In conclusion, Mr. Chairman, we are grateful for the opportunity to testify, and hope our concerns and recommendations will be considered in making constructive changes for the benefit of our nation's veterans.

This Subcommittee and the Congress have responded positively to such challenges in the past, and we are confident you will again. To you, Mr. Chairman, and Members of the Subcommittee, we express our sincere gratitude for your concern.

This concludes my statement, and I would be glad to answer any questions that I can.

Vietnam Veterans of America, Inc.
329 Eighth Street, N.E.
Washington, D.C. 20002

(202) 546-3700

STATEMENT OF DENNIS K. RHOADES

EXECUTIVE DIRECTOR OF THE

VIETNAM VETERANS OF AMERICA

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON VETERANS AFFAIRS

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS

MARCH 15, 1984

Good Morning, Mr. Chairman. My name is Dennis Rhoades, and I am Executive Director of Vietnam Veterans of America (VVA). VVA appreciates this opportunity to voice our concerns and share our views on this most important subject of proposed changes in the manner in which the Veterans Home Loan Mortgage Guaranty Program is administered.

As you may be aware, Mr. Chairman, Vietnam Veterans of America has publicly voiced our opposition to OMB's proposed changes in procedures governing foreclosures and acquisitions of property in the the Veterans Home Loan Guaranty Program. We believe a full review of such proposed changes by Congress is both warranted and necessary. The changes proposed by the Office of Management and Budget, and very nearly foisted on the Veterans Administration for implementation as of March 1, would have radically altered and crippled the Veterans Home Loan Mortgage Guaranty Program by administrative fiat.

What the Office of Mangement and Budget has proposed is to prevent the Veterans Administration from acquiring foreclosed properties, as is the Administrator's statutory right, forcing lenders to dispose of such properties. Most of the lenders who currently participate in the program, however, are not organized to be in the business of property disposition. They would be forced to incur substantial acquisitions, maintenance, and disposition expenses, IF they were to continue as participants in the program. I stress the word "IF", Mr. Chairman, because it is our understanding that many such financial institutions would not choose to participate in such a radically altered program, or, to

so change the manner of their participation such as to drastically alter the program from what has existed in the almost forty years since enactment by the Congress. That VA loan program has assisted over 11.2 million veterans to obtain housing since enactment by the Congress.

Among other effects, OMB's proposed changes would have a chilling effect on loans with no down payment. These represent currently approximately sixty percent of loans made under the program. These no down payment loans had an average purchase price and loan amount of $57,299. As the lending institutions would be subject to more exposure under the new guidelines, they will, quite naturally, move to protect themselves by demanding more equity at the outset from the veteran, and tend to award loans only to veterans that bankers consider to be more affluent, and who do not live in "red-lined" areas. It is important to bear in mind, Mr. Chairman, that only $27,500, or less than 50% of the average loan with no down payment would be guaranteed.

We believe that this would thwart the original intent of the program which was to enable veterans of modest means to realize the American dream of becoming first time homeowners. It would have a particularly adverse impact on hispanic, black, and other minority veterans; those veterans who are in rural areas of the country; and, those veterans who reside in areas of declining industries and high unemployment.

The reluctance of lenders to participate and make loans to veterans in these areas under the proposed changed groundrules is understandable, as rapid disposition of properties in these areas may in fact be more difficult.

We would also point out that because the lender is more at risk under the proposed change, it is likely that the speed of movement toward foreclosure and seizure of the property from the veteran and/or eviction his or her family, will be greatly hastened. Vietnam Veterans of America believes that this is movement would be in exactly the opposite direction from Congressional intent in establishing the program in the first place.

It is in everyone's interest for the veteran to keep the house as his or her primary residence in which the veteran has a vested interest to properly maintain and safeguard. When the veteran keeps the house, the house (and hence its value) is maintained, the lender gets paid, the VA does not incur foreclosure costs, and the veteran has the opportunity to work to make the American dream of home ownership a reality for his or her family. This was, and we hope still is, the congressional intent of this program.

Vietnam Veterans of America believes that "Section F" of the VA Lenders Handbook, if it were given the force of regulation, would be an excellent starting point for getting to the nexus of the problem, which is keeping the veteran stable and in vested

possession and residence in the house. Section F states "It is the policy of the VA, consistent with the beneficial nature of the law, to encourage holders to extend all reasonable forebearance in the event a borrower becomes unable to meet the terms of a loan. -----Accordingly, the regulations give the holder broad discretion in extending or recasting the terms of repayment in order to cure a default or to avoid imminent default." Mr. Chairman, Vietnam Veterans of America believes that that the spirit and intent of "Section F" should be promulgated by VA, by means of the public rule making process, in the regulations. Further, VVA recommends that specific forebearance requirements be built in to the mortgage instrument itself.

The formalization of Section F in regulation would move us toward the goal of forebearance in situations where the default is beyond the veteran's control, or where the default can be cured with the cooperation of all of the parties involved. By codifying the forebearance section in regulation, we believe that the attention of all concerned can be gained and properly focused on keeping the veteran in the home.

If, after a real and substantive effort, the financial institution cannot reasonably forebear, VA should then consider taking title to the property and let the veteran and his or her family continue to occupy their home. There are many sensible and effective arrangements that can be worked out, if all parties cooperate, that will allow the veteran to maintain the home and

eventually bring the loan current again, although possibly in "recasted" terms.

As we stated at our press conference on February 1st, the recession was cruel enough to millions of American families, including Vietnam-era veteran families. In fact, it is widely recognized that the recession disproportionately affected veterans of the Vietnam war, who experienced generally higher unemployment. Now that the economic recovery has begun, it would be a cruel twist of government policy to close down the main avenue for veterans--and especially younger veterans--to become homeowners, based on higher foreclosures during (and in large measure due to) the last recession. Yet, this is exactly what is contemplated.

Let there be no mistake, the OMB proposed change in policy may well deny home-ownership to tens of thousands of Vietnam-era veterans who were unable to buy homes during the recent recession, and who now hope to do so. In addition, the proposed changes may well increase the costs and expenses associated with the program, since reluctance by lending institutions to participate in the program may well trigger a "housing credit shortage area" determination pursuant to section 1811(b) of Title 38, thus requiring direct loans to veterans.

As noted above, Mr. Chairman, clear and creative thinking on the part of all parties involved can result in what is clearly in

everyone's interest namely, the veteran maintaining the home. VVA recommends that the Veterans Administration organize a special section or unit withn the Loan Guaranty Division of every Department of Veterans Benefits (DVB) VA Regional Office, that shall be responsible for implementing the policy and mechanisms of forebearance. This would include DVB working as a facilitator with the veteran and the lending institution, to reach solutions which meet everyone's legitimate interests during periods of difficulty. To be effective, the VA would need to stress to the veteran the existence and reason for the formal forebearance mechanism from the time of original application, and reinforce it at every step of the process.

It is crucial for the individual veteran to have it fixed in his or her mind not to wait if they are experiencing difficulty in meeting mortgage payments on time, for any reason. Rather, the veteran should be encouraged to communicate with the VA and the lending institution before the situation deteriorates, before the options open to all parties become increasingly limited. We would also recommend that the VA publish a fact sheet for every veteran, outlining how to structure legitimate alternatives to foreclosure and eviction.

Mr. Chairman, the State of Pennsylvania has moved to meet the problems of those in their state who are caught in hard times as a result of economic shifts and the current recession. On February 24, the Governor of Pennsylvania signed into law a Homeowner's

Emergency Mortgage Assistance program. All foreclosure in the state of Pennsylvania had been stayed since December, pending enactment of a reasonable way to deal with extrordinary problems being experienced by ordinary homeowners. This program provides for a loan in an amount sufficient to bring the loan current, and additional assistance available for a period of up to 36 months. This is a loan, but the obligation to begin repayment does not begin until ability to repay exists.

Mr. Chairman, we call on the Federal government to show at least as much faith and belief in our nation's veterans as the State of Pennsylvania does in all of its citizens by staying any further foreclosures and eviction of veterans and their families from their homes until the Congress and the Veterans Administration working in a cooperative manner, can move to develop a sensible set of regulations on foreberance procedures and options.

A final note, Mr. Chairman, on the sale of already acquired properties. Vietnam Veterans of America believes that VA-vendor financing on property sales should be extended only to veterans, for a limited time of six months, which every reasonable effort should be made to publicize the listing of these properties by the VA, working with the veterans service organizations. After six months, the property would then be made available on the open market, as a cash sale.

In summary, Mr. Chairman, the Office of Management and Budget has moved to solve problems of the business of administering the Veterans Home Loan Guaranty Program by moving toward putting the program out of business. We believe the Congress should further strengthen the Veterans Home Loan Mortgage, to make first home ownership possible for the average veteran. The National Association of Realtors stated recently that purchasing a typical home now requires an income twenty percent above the national median. In 1977, the same home was affordable with an income seventeen percent below the median. When seen in this light, the Veterans Home Loan Mortgage Guaranty Program is more important than ever to America's veterans. Now in fact may be the time to make changes in the program, but to strengthen it, thus making it available to more of those who served when needed. The changes proposed by OMB would do precisely the opposite.

Vietnam Veterans of America is grateful to you, Mr. Chairman, for this opportunity to share our views with you and your esteemed colleagues on the Committee on Veterans Affairs. Thank you.

THE NON COMMISSIONED OFFICERS ASSOCIATION OF THE UNITED STATES OF AMERICA

"STRENGTH IN UNITY"

Statement of

Richard W. Johnson, Jr.
Director of Legislative Affairs

before the

Subcommittee on Housing and Memorial Affairs
Committee on Veterans Affairs
U.S. House of Representatives

on

The Veterans Home Loan Guaranty Program

March 15, 1984

NATIONAL CAPITAL OFFICE
219 N. Washington Street • Alexandria, VA 22314 • Tele: (703) 549-0311

Mr. Chairman, the Non Commissioned Officers Association of the USA representing more than 250,000 associated members appreciates this opportunity to comment on the Veterans Home Loan Guaranty Program and the Grace Commission proposals to change major aspects of the program.

VA HOME LOAN GUARANTY PROGRAM

Since the program's inception under prior law more than 11,000,000 veterans have benefited from its provisions. Last year alone, under the current program, more than 285,000 veterans purchased homes with VA guarantees, including 53,000 active duty personnel. Literally millions of veterans enjoy the benefits of home ownership as a result of this program.

The attraction of the home loan guaranty program to both buyers and sellers is largely attributable to its versatility. It has something for everybody. For the veteran it provides an opportunity to buy a home with little cash investment--in essence, "no money down." Although the veteran must pay some closing costs and a loan origination fee, the dollar investment required is substantially less than in most other government or conventional loan programs. Additionally, veterans are not required to pay fees for private mortgage insurance (PMI) or fees for federal mortgage insurance.

Mortgage lenders have found veterans loans to be sound investments because the VA guarantees up to 60 percent of a loan to the limit of $27,500 under current law. Additionally, lenders have relied on the VA's policy of acquiring foreclosed properties as further assurance against a financial loss. This, of course, also works to the advantage of veterans because lenders are generally more liberal with loan qualification requirements due to the amount of protection the VA offers.

Investors and homesellers also derive certain benefits from the program. Without going into detail, investors have found the loans easy to resell because of the attendant guarantees. As a result more than $200 Billion of investment have been infused into the economy since the program began. Sellers have found veterans to be a reliable part of the marketplace creating demand for housing in an otherwise depressed industry.

Altogether, the Veterans home loan guaranty program has been a remarkable success. Both Congress and the Veterans Administration have been very responsive to the needs of veterans in this area and the collective effort is reflected in public law and federal regulation. NCOA is grateful to Congress and the VA for the efforts that have been made to keep the program current.

Grace Commission Recommendations

Notwithstanding the program's success, the President's Private Sector Survey on Cost Control (The Grace Commission) has recommended a major policy change in the program. According to the Grace Commission Report, the VA could reduce the program's cost by an estimated $225 million over the next three years if the VA abandons its current policy of acquiring and reselling homes that fall into foreclosure. As is the pattern in all Grace Commission findings the loan guaranty program has been compared to and evaluated with the most proximate private sector program, in this case private mortgage insurance. The Grace Commission however has neglected to discuss some of the major differences in the programs--differences which color the comparison.

Private mortgage insurance (PMI) is required by most lenders on loans amounting to more than 80% of the purchase price of the home. Its cost is directly related to the loan value usually requiring premium payment ranging from 1/2 of one percent to as much as 3 percent depending on the amount of down payment. The PMI premium is usually financed with the house and paid in monthly installments. Its value is usually 20 to 25 percent of the loan.

The Veterans Administration loan guaranty is not a premium based program. Losses are paid from the loan guaranty revolving fund, an appropriated account of the VA. Under current law, the maximum loan guaranty amount is the lesser of 60 percent of the loan or $27,500.

Obviously, the VA's losses are going to be more substantial than those suffered by PMI companies because the VA is liable for a greater portion of the loans they guarantee and because the losses are not offset by premium receipts.

The Grace Commission reports the average loss per case by the VA is about $6,700 and, by comparison, say the average PMI loss per case is about $1,000. The VA's loss per case may continue to rise as home values and guaranty amounts increase. Nevertheless, the VA has done everything possible under the program to minimize the loss by acquiring the foreclosed properties and reselling them, albiet at a loss. The actual loss is less than the guaranty amount.

It is distressing to know the VA currently has an inventory of 22,000 properties nationwide. It is even more distressing when considering that each of those properties represent a homeless veteran and his or her family. Moreover, nearly $1 billion is obligated to the purchase and maintenance of those homes until the VA can arrange their sale. Using the Grace Commissions figures, the VA will lose $140 million on the sale of those properties over the next three years. If the VA simply paid the guaranty amount, the loss would exceed $210 million over the same period, a difference of more than $70 million.

Private Mortgage Insurers, according to the Grace Commission, are smarter about acquisitions. It seems never to have occurred to the

Grace Commission that PMIs selective acquisition procedures are designed to minimize loss, not avoid it entirely. Still PMI losses are offset by premiums. Certainly PMIs are not going to acquire every home in foreclosure, particularly in areas where home sales are depressed. If the PMI can be reasonably certain its loss through acquisition and resale will be lower than its loss through payment of the insured amount then property acquisition makes sense. The VA's more extensive acquisition policy is an extension of the same logic. The VA is, in fact, losing about $9,000 per case on acquisition and resale but would lose over $19,000 per case if acquisitions were stopped and guarantees were paid.

The VA's current policy also works to the distinct advantage of veterans. First, lenders realize that current VA policy reduces their potential for loss. Accordingly, marginally qualified veterans receive the benefit of doubt from many lenders. NCOA believes a shift in acquisition policy will result in more stringent loan qualification requirements and perhaps the imposition of higher loan fees to sellers thus making VA loans less attractive. Second, when foreclosure is effected the VA frequently does not require immediate eviction of the veteran and his or her family thus allowing the veteran an extended opportunity to preserve his or her investment. Finally, any guaranty loss suffered by the VA becomes a debt to the veteran. The VA's proposed change in policy is not likely to result in an improved debt collection record but would place an additional burden on an already financially troubled veteran.

The VA currently recovers about 17 cents on each dollar of debt incurred by a veteran. Any remainder is usually forgiven and serves only to restrict a veteran's eligibility for future entitlements. This, too, may change.

An Office of Management and Budget directive to all federal agencies now requires the VA to report amounts of all forgiven debts (not just loan guaranty debts) to the Internal Revenue Service as earned income of the veteran. Veterans, as a result, will be required to pay income tax on the amounts reported by the VA. It does not take a wizard to see that such a reporting policy is somewhat absurd. If the veteran cannot afford to repay a VA debt, in all likelihood the veteran will not be able to pay the tax. At least the current VA acquisition policy minimizes the amount of the veteran's debt.

Conclusion

In summary, NCOA believes the VA's acquisition policy is sound and should not be changed. The benefits it provides to veterans are outstanding and it demonstrates good stewardship of taxpayer funds by the VA. NCOA is pleased by the VA's decision to reserve such changes until their potential impact can be fully explored. We remain hopeful the exploration will prove the plan should not be implemented. Meanwhile, the VA budget must be adjusted.

Budget Impact

The number of foreclosures and acquisitions during the past two years have placed a great deal of pressure on the loan guaranty revolving fund. As a result the fund, which once regularly profited from the acquisition and sale of foreclosures, is now losing money. While foreclosures and acquisitions will probably decline as the economy continues to improve, the immediate adequacy of the fund remains questionable. The status of the fund can be reasonably expected to improve when the sale of properties exceeds those newly acquired but it is unreasonable to expect recovery to take place before an additional appropriation is required to sustain the fund. Authorizing the deposit of loan fees collected under current law into the loan guarantee revolving fund will help reduce the anticipated deficit.

NCOA, however, strongly opposes the idea of increasing the loan fee or an extension of the loan fee program as is currently being considered by the Senate.

Additionally, in anticipation of the policy change, the VA has presented a budget request NCOA believes is inadequate to sustain the program. The request suggests the reduction of 136 Full Time Equivalent Employees (FTEE) at a savings of $3.9 million and a reduction of $1.11 million in obligations under the guaranty program. NCOA is not certain the proposed policy change justifies a 7

percent personnel cut in the program, but it is certain the program cannot be sustained at its current level of effectiveness if such cuts are imposed. At the same time, it is not likely that a $1.11 million savings in obligations can be realized. The Association therefore urges the restoration of these amounts to the VA budget request.

The Future

Finally, the VA and Congress must be mindful of the future in any changes made in the loan guaranty program. Recent changes in the FHA loan rate structure allowing FHA loans to be made at market interest rate rather than fixed rate is making FHA loans more attractive to lenders and sellers. The higher interest rates and the associated decline in loan discount points for FHA loans may result in reduced desirability of veterans loans. Although it is too early to tell, NCOA believes veterans' loans will remain competitive and highly acceptable to lenders. In the opinion of the Association, the VA loan guaranty rate will now become the standard by which all other mortgages are gauged --in essence, the last control on interest rates, external to the mortgage industry. Accordingly, even more caution must be exercised in making any changes in the loan guaranty program that may affect the market stature of veterans loans.

TESTIMONY OF DAVID J. PASSAMANECK

Lt. Col., USA, Ret.

NATIONAL LEGISLATIVE DIRECTOR, AMVETS

Before The

SUBCOMMITTEE ON HOUSING

AND MEMORIAL AFFAIRS

OF THE

U. S. HOUSE OF REPRESENTATIVES

On

PROPOSED CHANGE IN VETERANS ADMINISTRATION

LOAN GUARANTEE PRACTICES

0900, 15 March 1984

Room 334, Cannon House Office Building

AMVETS is pleased to have this opportunity to comment on the proposed change in VA loan guarantee policy which would, in effect, convert the VA into an insurer of the pro-rata share of home loans, rather than a vital cushion to absorb the shock of foreclosure for the benefit of the mortgage industry and, of course, the veteran.

If the VA forces the lenders to assume the burden of carrying in their inventory the foreclosed properties which the VA now redeems and markets, not only will the cost to the government on each transaction rise by approximately $5,000, but the cost of financing to the veteran will undoubtedly drive many, if not most of the current veteran borrowers out of the ranks of home owners. The no-down payment loan may well be rare if not entirely un-workable if the VA stops acquiring foreclosed properties.

Of paramount importance in the discussion of the Grace Commission's proposal regarding the VA loan guarantee program is the simple fact that the benefit or interest of the veteran did not fit into their calculations. Whatever can be said regarding the relative losses or savings to the government or the mortgage industry, everyone agrees that the veteran will suffer. This proposed change in practice completly ignores the government's obligation towards it's veterans as a continuing cost of war and national defense. Even if it could be argued that the Grace Commission proposal is consistent with efficient

money saving business practices, the proposal completely ignores the VA's role as a provider of earned service and entitlements to veterans rather than a profit making business.

AMVETS appreciates the efforts of the Administrator of Veterans Affairs to forestall the implementation of the change at least so long as all other federal home loan programs are not required to stop acquiring foreclosed properties. We do not however, accept the concept that the veterans' programs are to be evaluated according to the same criteria as other government income transfer, guarantee or benefit programs.

We take the position that national defense and veterans come first in the allocation of government resources and last in the cutting of budget deficits. The Office of Management and Budget and the Grace Commission put it just the other way around. According to Budget Director Stockman and Senator Laxalt, among others, the Administration will not begin cutting veterans' entitlements and military compensation until after the elections. With this proposed crippling of the loan guarantee program, it looks like they have started well before the elections.

THIS CONCLUDES MY TESTIMONY.

BLINDED VETERANS ASSOCIATION
1735 DeSALES STREET, NORTHWEST • WASHINGTON, D. C. 20036 • (202) 347-4010

TESTIMONY OF THE BLINDED VETERANS ASSOCIATION

AS PRESENTED BY

National President Thomas H. Miller

Before a Hearing of The

Subcommittee on Housing And

Memorial Affairs of The

Veterans Affairs Committee

U.S. House of Representatives

March 15, 1984

CHARTERED BY THE CONGRESS OF THE UNITED STATES

On behalf of the Blinded Veterans Association, I am very pleased to submit to this subcommittee this statement expressing our views on the recommendations of the Grace Commission concerning the VA's Home Loan guaranty program.

The BVA is a nonprofit organization founded in 1945 by a group of veterans blinded during World War II. We are chartered by the U.S. Congress as the official representative of blinded veterans.

The BVA is the only organization of its kind. It is the only organization with programs and activities which emphasize seeking out blinded veterans where they live. It is the only organization committed to reaching out to blinded veterans to offer the support and assistance that is needed. Programs offered by the BVA encourage blinded veterans to assume an active role in life. The BVA helps blinded veterans obtain the benefits for which they are eligible, which not only include disability compensation and pension, but also rehabilitative training, prosthetic and sensory aids, and medical treatment. The BVA also conducts a program to help blinded veterans develop satisfying careers. We provide assistance ranging from resume preparation to contact with prospective employers. We conduct an information program and publish a bimonthly publication for blinded veterans which is printed in large type and available on recorded discs.

The BVA is concerned with any legislation or administrative changes which adversely affect blinded veterans. This statement voices our concerns over the recommended policy changes in the VA's Home Loan Program.

The Grace Commission, the President's Private Sector Survey on Cost Control, has recommended that the VA no longer acquire foreclosed properties and should, instead, pay to the holder of the loan in all cases the amount originally guaranteed. This change of policy is scheduled to be implemented on

October 1, 1984. We believe that this measure which originated as an attempt to cut administrative costs will adversely affect veterans, especially disabled veterans, who attempt to use the VA's Home Loan Guaranty Program to secure a home loan.

The BVA is opposed to any changes in the VA Home Loan Guaranty Program which make it more difficult for qualified veterans to obtain loans to purchase homes. Since the VA's Home Loan program was established under the Serviceman's Readjustment Act of 1944, it has provided benefits by guaranteeing a portion of the veteran's mortgage principal and by requiring no downpayment or minimal downpayment. Many first-time homebuyers and veterans with low incomes have been able to use this program to purchase homes which, otherwise, they would never have been able to own.

The VA is currently authorized to guarantee 60 percent of the loan amount or $27,500, whichever is less, to eligible veterans for purchase of their primary residential property. Lenders will extend mortgage credit properties at lower rates and under more favorable terms, such as no downpayment, to veterans because of the VA guaranty.

In the event of default in the payment of a guaranteed loan, resulting in foreclosure, the VA in 95 percent of the cases acquires title to the property. The property is then sold so the VA can recoup part or all of its expenditures. In many cases, the veteran, who is unable to maintain payments on the house, is permitted to continue occupying the house as long as possible. If the VA would turn these defaulted properties over to lenders or third parties, the veteran probably would be immediately evicted.

The Mortgage Bankers Association warns that VA guaranteed loans will be perceived as carrying a much larger risk to lenders in the mortgage markets if this Grace Commission recommendation is implemented. Applications of prospective VA borrowers would be reviewed stringently and lenders might

even cease to offer VA loans in small towns, rural areas, and economically depressed areas where a foreclosed property might be especially difficult to sell.

This change of policy would be detrimental to the veteran in other ways as well. Lenders would charge a higher interest rate on these loans to make up for the additional risk involved and would probably no longer make loans to veterans with no downpayment. Vietnam-era veterans, who have been especially hard hit by recession and unemployment, would have great difficulty entering the housing market as first-time homebuyers. They will not be able to come up with the higher downpayments to purchase homes or they could be forced to pay higher interest rates.

The BVA has a resolution approved by our delegate body which expresses our view that home ownership is a goal of the American family. This resolution also recognizes that the cost of homes has risen greatly, interest rates have become exorbitant, and discount policies at commercial lending institutions have combined to make home ownership for many 100 percent service-connected disabled veterans difficult, if not impossible. During the past year we recommended that Congress pass legislation authorizing the VA to make direct low interest loans to service-connected disabled veterans rated as "n".

The turn of economic events in the last few years has made the dream of home ownership more and more difficult to realize. The effects of our current economic conditions have adversely affected the housing and construction industries.

Despite the fact that interest rates have declined and despite the fact that the rate of inflation also has declined over the last two years, the costs of housing remain high. The result: newly constructed homes lay vacant; planned communities are undeveloped; and mortgage foreclosures have reached

an all time high. Unfortunately, the reality is that the high costs of housing are here to stay. Many disabled veterans need special assistance, if they are ever to realize their hopes of home ownership.

The BVA is most concerned with the inability of the service-connected blinded veteran to own his home. The incomes of disabled veterans are fixed incomes. Blinded veterans in recent years have struggled simply to keep up with the increases in the cost of living. Food and utilities continue to take greater chunks from disability incomes. Extra non-medical costs related directly to blindness also increase dramatically.

It is the segment of the population on fixed incomes who see the dream of home ownership fading away. The situation is especially tragic for the severely disabled veteran, who because of his disability, which was incurred in service to the nation, has seen his social and economic mobility frustrated, and in some cases, even halted.

Housing patterns of disabled veterans--especially blinded veterans--further aggravate the situation. By the nature of the disability and reduced individual mobility, the blinded veteran must live often in metropolitan areas--actually within the inner city--where public transportation is accessible. And as we all know, housing costs in urban settings are higher than those in rural settings.

The situation is even further complicated by the sad state of many savings and loans associations and banks throughout the country. Many savings and loans associations and banks will not make GI and FHA home loans. The problem is most acute for the veteran not fortunate enough to have purchased a home when interest rates were realistic. In essence, we are talking about our younger veterans.

At a time when the VA should be expanding opportunities for veterans
o purchase their own homes, we find instead recommendations from the Grace
mmission which would have an adverse effect both on veterans and the entire
rtgage loan system.

And it will be the veterans who represent marginal financial cases who
ll suffer most. The mantle of the VA Home Loan Program often is the crucial
actor in granting a home loan. If the VA Home Loan Program loses this mantle,
hen, all veterans will suffer as will the housing and construction industries.
ertainly, this will also hurt the nation's economic recovery.

The overall burden will fall inordinately on disabled veterans. Blinded
eterans will be especially hard hit because it has long been recognized that
incomes of the blind and visually impaired fall below those with other types
of disabilities.

We urge this subcommittee to carefully consider the impact of the Grace
ommission recommendations and reject this proposal which will limit and
rustrate veterans' attempts to obtain loans.